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ANNUAL PUBLIC DEBT MANAGEMENT REPORT 2014/2015

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ANNUAL PUBLIC DEBT REPORT 2014/2015

KENYA

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FOREWORD

Kenya continues to enjoy stable macroeconomic environment with vibrant public and private sectors. Kenya's economic stability, characterized by low inflation, robust economic growth, a floating and stable domestic currency, and political stability makes it a highly attractive investment destination.

The objective of this Annual Public Debt Management Report 2014-2015 is to inform all stakeholders including investors about the financing of the national government, to analyse the characteristics of the public debt and to describe the developments in the Kenyan Government securities market in 2014/15.

The growth in public debt and budget deficit levels have been within sustainable levels. The Government, in collaboration with the International Monetary Fund and the World Bank, conducted a Debt Sustainability Analysis (DSA) in September 2015. The DSA results show that Kenya's public debt situation is sustainable in both the medium and long term. Prudent public debt management is important to ensure debt sustainability. The Government of Kenya, therefore, will continue to ensure that national debt remains on a sustainable path and that a credible strategy is in place to reduce excessive levels of debt.

The National Treasury is publishing this Report, which is regarded as best practice in public debt management in terms of transparency and accountability. The publication and dissemination of the Report demonstrates Government's commitment to providing timely and accurate public debt information to all stakeholders. This year's report is part of the series of annual debt publications the National Treasury has been undertaking since 2004.

Kenya's credibility with domestic and international investors remains high. The country's success in managing its public debt has also contributed to achieving macroeconomic stability. It is the hope of the National Treasury that, this report contributes towards ensuring institutional transparency.

HENRY K. ROTICH, EGH
CABINET SECRETARY/THE NATIONAL TREASURY

ACKNOWLEDGEMENT

Effective debt management has been through teamwork and significant contributions from collaborating institutions. In this regard, we would like to recognize the cooperation of staff members of the National Treasury and the Central Bank of Kenya for the continued collaboration in managing the public debt.

This Report was prepared by the staff of the Directorate of Public Debt Management Office with useful contribution from the Central Bank of Kenya. Their efforts are greatly appreciated. To readers and users of the Report, the National Treasury hopes that this publication will provide useful information and enhance understanding of public debt dynamics in line with principles of transparency and accountability.

DR. KAMAU THUGGE, CBS

PRINCIPAL SECRETARY/THE NATIONAL TREASURY

Abbreviations and Acronyms

ADF	African Development Fund
AfDB	African Development Bank
A-I-A	Appropriation in Aid
ATM	Average Time to Maturity
BPS	Budget Policy Statement
Bps	Basis points
CBK	Central Bank of Kenya
CCN	City Council of Nairobi
CPIA	Country Policy and Institutional Assessment
DMD	Debt Management Department
DSA	Debt Sustainability Analysis
FCCL	Fiscal Commitments and Contingent Liabilities
FY	Financial year
GDP	Gross Domestic Product
GoK	Government of Kenya
GSMM	Government Securities Market Makers
HIPC	Highly Indebted Poor Countries
IDA	International Development Association
IFB	Infrastructure Bond
IMF	International Monetary Fund
ISB	International Sovereign Bond
KBC	Kenya Broadcasting Corporation
KenGen	Kenya Electricity Generating Company
MDRI	Multilateral Debt Relief Initiative
MTDS	Medium Term Debt Management Strategy
NBFI	Non-Bank Financial Institution
NCC	Nairobi City County
NSE	Nairobi Securities Exchange
NSSF	National Social Security Fund
NT	National Treasury
OTC	Over – the- Counter
PD	Primary Dealers
PDMO	Public Debt Management Office
PFMA	Public Finance Management Act
PPG	Public and Publicly Guaranteed
PPP	Public Private Partnership
PV	Present Value
SGR	Standard Gauge Railway
S&P	Standard and Poor's
SOE	State Owned Enterprise
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TEDS	Total External Debt Service
TMD	Treasury Mobile Direct
UK	United Kingdom
USA	United States of America
USD	United States Dollar

EXECUTIVE SUMMARY

Overall, the outstanding total public debt amounted to Ksh 2,843,696 million by end June 2015 compared to Ksh 2,422,832 billion by end of June 2014, an increase of 17 per cent. By the end of June 2015, the share of total domestic and external debt in total public debt was equally split at 50 per cent each. The share of total debt to GDP was 49.9 per cent in June 2015 from 48.0 per cent in June 2014.

Arising from the Government external debt strategy of contracting external loans on highly concessional terms to minimise cost, the average interest rate and grace period on new external loans contracted in financial year 2014/15 was 2.5 per cent and 6.4 years respectively. This profile, together with the long maturity of 21 years yield an average grant element of 63.2 per cent for new external loans. On the other hand, reflecting the success of lengthening the maturity of domestic debt to minimise refinancing risk, the average maturity profile of outstanding Government domestic debt has increased from 4.9 years as at end June 2014 to 5.3 years by June 2015.

The outstanding domestic debt increased from Ksh 1,284,327 million as at end June 2014 to Ksh 1,420,444 million as at end June 2015, an increase of 11 per cent. Domestic debt accounted for 50 percent of total public debt. The proportion of Treasury Bonds in total domestic debt increased from 71.2 per cent in 2013/14 to 72.9 per cent in 2014/15 while Treasury Bills declined from 23.3 per cent to 22.5 per cent during the same period.

Commercial banks were the largest holders among all investor categories of public domestic debt and held Ksh 730,419 million (51.4 per cent) of the total domestic debt at end of June 2015 compared to Ksh 617,221 million (48.1 per cent) at end June 2014. The share held by non-bank investors in total domestic debt stock decreased marginally from 46.8 per cent in June 2014 to 44.1 per cent in June 2015.

Kenya's outstanding external debt (including publicly guaranteed debt) stock rose from Ksh 1,138,505 million as at end June 2014 to Ksh 1,423,252 million as at end June 2015, an increase of 25 per cent. External debt accounted for 50% of total public debt.

Publicly guaranteed debt, which accounted for 4.0 per cent of total external debt as at June 2014, declined to 3.1 per cent at end June 2015 (bilateral creditors accounted for 89.9 per cent of the publicly guaranteed debt; multilateral, 10.1 per cent as at end June 2015).

Multilateral creditors accounted for 48.1 per cent of total external debt while bilateral and commercial banks accounted for 31.3 per cent and 19.5 per cent respectively. Debt owed to suppliers' credit was low at 1.2 per cent as at June 2015.

Currency composition of external debt shows that United States Dollar was the dominant currency accounting for 56.7 per cent followed by the Euro at 23.9 per cent, Japanese Yen at 9.2 per cent, and Sterling pound at 5.4 per cent and the Yuan at 4.3 per cent at end June 2015. Other currencies account for the remainder of 0.5 per cent.

The total public debt service payments as at June 2015 amounted to Ksh 253,271 million. The total external (interest and principal) and domestic debt service was Ksh 113,544 million and Ksh 139,727 million respectively. The amount expended on debt service increased by Ksh 92,671 million or about

57.7 per cent over a total of Ksh 160,600 million spent by June 2014 mainly on account of repayment of USD 600 million external syndicated loan during the FY2014/2015

As a percentage of the total public debt service, the shares of the external and domestic debt service were 44.8 per cent and 55.2 per cent at June 2015 compared to 25.8 per cent and 74.2 per cent, respectively by June 2014. The ratio of public debt service to revenues rose from 17.5 per cent as at end June 2014 to 24.6 per cent at end June 2015.

The outstanding Government guaranteed debt decreased by Ksh 1,288 million to Ksh 43,933 million in June 2015 from Ksh 45,221 million in June 2014. The outstanding on-lent loans excluding arrears and interest increased by Ksh 15,565.8 million from Ksh 181,287.3 million at end June 2014 to Ksh 196,853.10 million at end June 2015 mainly attributed to new loans on-lent to the Water and Irrigation, Energy and Petroleum sectors.

Overall, as at end June 2015, the total on-lent loan portfolio amounted to Ksh 233,682.8 million, out of which outstanding loans, principal arrears and accrued interest stood at Ksh 196,853.1 million, Ksh 12,334.6 million and Ksh 24,495.1 million, respectively.

Debt Sustainability Analysis (DSA) conducted in 2015 concludes that Kenya's debt is sustainable. The DSA compares debt burden indicators to indicative thresholds over a 20-year projection period. A debt-burden indicator that exceeds its indicative threshold suggests a risk of experiencing some form of debt distress. The PV of public debt-to-GDP was at 45.8 per cent in 2014 but is expected to gradually decline to 43.1 per cent by 2020. In the long term, the ratio is expected to decline to 37.3 per cent in 2024. The debt service-to-revenue ratio remains within sustainable levels.

The legal framework for public debt management in Kenya is supported by provisions made in the Constitution, Article 211(1) which states that Parliament may, by legislation—(a) prescribe the terms on which the national government may borrow; and (b) impose reporting requirements. The enabling legislation is the Public Finance Management Act (No. 18 of 2012) which give effect to the Constitution and prescribes terms of borrowing and operational procedures for borrowing and guarantees.

The total public debt is projected to rise in nominal terms to Ksh 3,238,700 million in June 2016 from Ksh 2,843,696 million in June 2015 and further increase to Ksh 4,451,400 million in June 2019. As a proportion of GDP, public debt in nominal terms is projected to increase to 50.3 per cent in June 2016 from 49.9 per cent in June 2015 but decline to 48.7 per cent in June 2019.

In nominal terms, the total debt service is projected to decrease from 24.3 per cent of revenue in 2014/15 to 22.6 per cent in 2017/18, and further decline to 20.3 per cent of revenue in 2018/19. As a percentage of GDP, total debt service is projected to decrease from 4.4 per cent in 2014/15 to 3.6 per cent in 2015/16 but increase to 4.0 per cent in 2018/19.

KEY INDICATORS OF PUBLIC DEBT, 2012 – 2015

INDICATOR	Unit	June 2012	June 2013	June 2014	June 2015
PUBLIC DEBT					
Total Public Debt (including guaranteed Debt)	Ksh million	1,622,801	1,894,117	2,422,832	2,843,696
	% of GDP	40.7	42.1	48.0	49.9
Total Domestic Debt	Ksh million	858,830	1,050,555	1,284,327	1,420,444
	% of total debt	52.9	55.5	53.0	50.0
Domestic Debt to GDP	%	21.5	23.3	25.5	24.9
Total External Debt (including publicly guaranteed Debt)	Ksh million	763,971	843,562	1,138,505	1,423,252
	% of total debt	47.1	44.5	47.0	50.0
External Debt to GDP	%	19.2	18.8	22.5	25.0
DEBT SERVICE					
Total Debt Service	Ksh million	113,644	145,228	160,600	253,271
• Domestic interest	Ksh million	82,339	110,184	119,200	139,727
• External (interest and principal)	Ksh million	31,305	35,044	41,400	113,544
• Total Debt Service as a % of Revenue	%	16.5	18.7	17.5	24.6
• Total External Debt Service as a % of Exports	%	6.3	6.6	7.9	21.6
NEW EXTERNAL LOAN COMMITMENTS					
• Average Maturity	Years	26.3	33.7	18.1	21.0
• Average Grace Period	Years	6.2	8.0	6.2	6.4
• Average Interest Rate	%	0.8	1.2	2.6	2.5
• Average Grant Element	%	65.8	68.6	63.9	63.2
DOMESTIC DEBT-new commitments					
Average Maturity	Years	5.3	5.2	4.9	5.3
DOMESTIC DEBT STOCK BY INSTRUMENT					
• Treasury Bills	Ksh million	132,047	267,211	299,406	318,929
	%	15.4	25.4	23.3	22.5
• Treasury Bonds	Ksh million	686,951	744,174	914,762	1,035,662
	%	80.0	70.8	71.2	72.9
• Others (Pre-1997 Government Debt, CBK Overdraft, etc.)	Ksh million	39,832	39,170	70,159	65,853
	%	4.6	3.8	5.5	4.6
DOMESTIC DEBT STOCK BY HOLDER					
• Commercial Banks	Ksh million	411,867	524,505	617,221	730,419
	%	48.0	50.0	48.1	51.4
• Non-bank Financial Institutions and Other sources	Ksh million	399,580	486,880	601,406	626,689
	%	46.5	46.3	46.8	44.1
• Central Bank	Ksh million	47,383	39,170	65,700	63,335
	%	5.5	3.7	5.1	4.5
EXTERNAL DEBT STOCK BY BROAD CREDITORS (including publicly guaranteed debt)					
Multilateral	Ksh million	455,077	511,791	597,340	684,631
	%	59.6	60.7	52.6	48.1
Bilateral	Ksh million	243,543	257,637	289,914	445,057
	%	31.9	30.5	25.5	31.3
Commercial Banks	Ksh million	50,540	58,928	234,799	276,937
	%	6.6	7.0	20.7	19.5
Export Credit	Ksh million	14,812	15,453	14,537	16,628
	%	1.9	1.8	1.3	1.2
Total	Ksh million	763,972.0	843,808.5	1,136,590.0	1,423,252
	%	100.0	100.0	100.0	100.0
GUARANTEED EXTERNAL DEBT STOCK	Ksh million	47,383.4	43,537.2	45,221.1	43,933.6
CURRENCY STRUCTURE OF EXTERNAL DEBT					
US Dollar	%	33.0	32.3	42.8	56.7
Euro	%	31.0	33.0	28.5	23.9
Yen	%	19.0	15.1	11.5	9.2
Sterling Pound	%	6.0	5.5	4.7	5.4
Yuan	%	4.0	5.7	4.8	4.3
Others	%	7.0	8.4	7.7	0.5

Source: National Treasury, 2016 Budget Policy Statement

STRUCTURE OF THE REPORT

This report comprises ten chapters. Chapter one provides an overview of financing of the FY2014/15 budget deficit as well as a description of the domestic and external debt. The detailed Domestic Debt is presented in Chapter Two and External Debt in Chapter Three.

On-Lent Loans is dealt with in Chapter Four. Chapter Five gives an overall description of the Fiscal Commitments and Contingent Liabilities and Publicly Guaranteed Debt. The Disputed External Commercial Debt is presented in Chapter Six while Chapter Seven presents Debt Strategy and Debt Sustainability.

Chapter Eight presents the International Sovereign Bond while Chapter Nine describes the Legal framework on Public Debt Management. Lastly, Chapter Ten describes the Outlook for the Medium Term.

CHAPTER ONE: AN OVERVIEW OF FINANCING OF THE NATIONAL GOVERNMENT'S BUDGET DEFICIT AND PUBLIC DEBT

1.1 Economy

Kenya's Gross Domestic Product (GDP) is estimated to have expanded by 5.3 per cent in 2014, compared to a growth of 5.7 per cent in 2013. Economic trends in 2014 were primarily driven from the demand side, by an increase in private final consumption and a rapid growth in capital investment. From the supply side, the major drivers of the economy were agriculture, forestry and fishing; construction; wholesale and retail trade; education; and finance and insurance. Inflation rate in 2014 was 6.9% compared to 5.7% in 2013.

1.2 Appraisal of Medium Term Debt Management Strategy

Kenya's public borrowing is guided by the Medium Term Debt Management Strategy (MTDS) which the National Treasury has been designing for the last seven years. In line with international best practice, an evaluation of debt management strategy is useful to assess the extent to which the debt management activities complied with strategies as stipulated in the MTDS 2014.

The key objective for the 2014 MTDS was to meet the Government financing requirements at the least cost with a prudent degree of risk. This was to be achieved through diversification of sources of financing and lengthening the Average Time to Maturity (ATM) of the domestic debt portfolio. The secondary objective was to facilitate Government's access to financial markets and support development of a well-functioning and vibrant domestic debt market.

In 2014/15, the Government highlighted the need to minimize the degree of foreign exchange rate risk exposure associated with the external debt portfolio by borrowing more concessional debt, while maintaining a limited window for borrowing on commercial terms to minimize costs.

The 2014 MTDS adopted an optimal strategy after taking into account both risk and cost trade-offs, the implied quantity of gross borrowing, the need to develop the domestic debt market and ability to implement the strategy. The 2014 MTDS proposed the most optimal strategy with the following features: External and domestic borrowing would amount to 40 per cent and 60 per cent of gross financing needs respectively with a concentration of more concessional external debt to reduce cost.

1.2.1 External Debt Management Strategy

The broad objective of Kenya's public external debt management strategy was to prudently access concessionary financing to fund growth and development within a sustainable debt profile. New external debt was sourced from the concessional window in 2014/15 with a grant element of 63.2 per cent, an average maturity of 21.0 years and an average interest rate of 0.6 per cent. The long maturity structure of external debt was to minimise the refinancing risk in line with the 2014 MTDS.

1.2.2 Domestic Debt Management Strategy

The domestic debt management strategy, apart from funding government's financing needs, sought to broaden and deepen the domestic bond market through the introduction and implementation of initiatives aimed at developing a vibrant domestic secondary market for Government securities.

1.3 Financing Fiscal Balance

The overall actual FY2014/15 fiscal balance was Ksh 471,573 million (8.3 per cent of GDP) and was financed through net external financing to the tune of Ksh 217,479 million (3.8 per cent of GDP), net domestic financing of Ksh 251,102 million (4.4 per cent of GDP) and domestic loan repayments receipts of Ksh 2,992 million (0.1per cent of GDP) (Table 1-1).

Table 1-1: Kenya Financing Fiscal Balance, 2014/15 in (Ksh million)

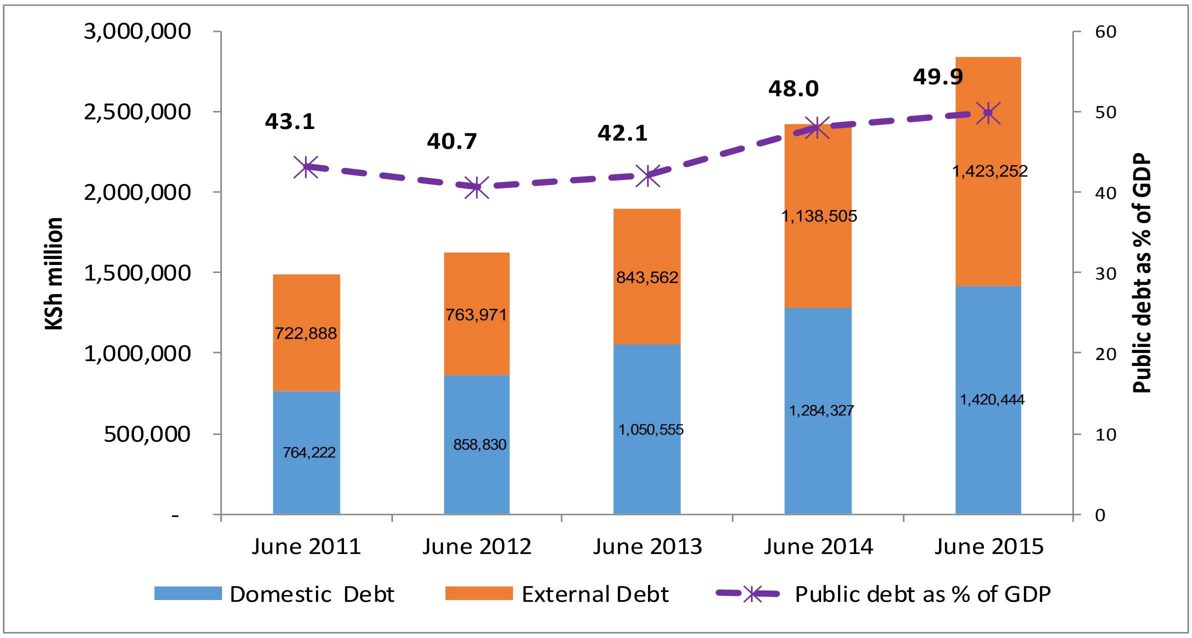
Financing item	Ksh million	As % of GDP
Net Foreign Financing	217,479	3.8
Domestic Loan Repayments(Receipts)	2,992	0.1
Net Domestic financing	251,102	4.4
Total	471,573	8.3

Source: National Treasury, 2016 Budget Policy Statement

1.4 Trends in Total Public debt

As at end June 2015, the outstanding total public debt, including publicly guaranteed debt, amounted to Ksh 2,843.7 billion (Figure 1-1) compared to Ksh 2,422.8 billion by end of June 2014, an increase of 17 per cent. Domestic debt increased from Ksh 764,222 million in June 2011 to Ksh 1,284,327 million in 2014 and further to Ksh 1,420,444 million in June 2015. On the other hand, external debt (including guaranteed debt) increased from Ksh 722,888 million in June 2011 to Ksh 1,423,252 million in June 2015.

Figure 1-1: Trend in Kenya's Public and Publicly Guaranteed Debt Stock, 2011- 2015 in (Ksh million)



Source: National Treasury and Central Bank of Kenya

Domestic debt accounted for 51.4 per cent of total public debt at the end of June 2011 rising to 55.5 per cent at end of June 2013 whereas, external was at 48.6 per cent as at end June 2011 and falling to 44.5 per cent as at end June 2013. By the end of June 2015, the share of total domestic and external debt in total public debt had equalled at 50.0 per cent each (Table 1-2).

The share of total debt to GDP was 49.9 per cent in June 2015 from 48.0 per cent in June 2014. The total domestic debt as a percentage of GDP decreased marginally to 24.9 per cent at the end of June 2015 from 25.5 per cent at the end of 2014 while total external debt as a percentage of GDP increased to 25.0 per cent at the end of June 2015 from 22.5 per cent at the end of June 2014, reflecting a higher percentage increase in external debt compared to that of domestic debt at the end of June 2015. The rise in external debt largely comprised proceeds of the Eurobond tap sale in December 2014, disbursements for the construction of the Standard Gauge Railway (SGR) and depreciation of the shilling exchange rate. On the whole, despite the increase, the public debt remained at a level below the debt sustainability threshold indicator of present value of public debt-to- GDP ratio of 74 per cent by June 2015.

Table 1-2: Trends in Kenya's Total Public Debt in (Ksh million)

Debt Type	June 2011	June 2012	June 2013	June 2014	June 2015
DOMESTIC DEBT					
Central Bank	39,691	47,383	39,170	65,700	63,335
Commercial Banks	384,640	411,867	524,505	617,221	730,419
Sub-total: Banks	424,331	459,250	563,675	682,921	793,754
Non-bank Financial Institutions	339,891	399,580	486,880	601,406	626,690
Total Domestic	764,222	858,830	1,050,555	1,284,327	1,420,444
As a % of GDP	22.1	21.5	23.3	25.5	24.9
As a % of total debt	51.4	52.9	55.5	53	50
EXTERNAL DEBT					
Bilateral	215,035	199,950	217,970	248,636	405,562
Multilateral	436,838	451,287	507,920	593,397	680,192
Commercial Banks	-	50,540	58,928	234,799	276,937
Suppliers Credits	25,041	14,811	15,207	16,452	16,628
Sub-Total	676,914	716,588	800,025	1,093,284	1,379,319
GUARANTEED DEBT					
Bilateral	41,930	43,593	39,667	41,278	39,495
Multilateral	4,044	3,790	3,870	3,943	4,439
Sub-Total	45,974	47,383	43,537	45,221	43,934
Total External debt	722,888	763,971	843,562	1,138,505	1,423,252
As a % of GDP	21.0	19.2	18.8	22.5	25.0
As a % of total debt	48.6	47.1	44.5	47	50
GRAND TOTAL	1,487,110	1,622,801	1,894,117	2,422,832	2,843,696
Total debt As a % of GDP	43.1	40.7	42.1	48.0	49.9
Memorandum item					
GDP* (in Ksh million)	3,447,694	3,990,412	4,496,000	5,044,236	5,703,321

*Note: * GDP for years ending June 2011, June 2012 and June 2013 are the rebased figures to make them comparable with those of years ending June 2014 and June 2015.*

Source: National Treasury and Central Bank of Kenya

1.5 Debt Service

The public debt servicing includes payment of principal, interest and other contractual obligations in relation to debt obtained by the Government. The total public debt service payments as at June 2015 amounted to Ksh 253,271 million. The amount expended on debt service increased by Ksh 92,671 million or about 57.7 per cent over a total of Ksh 160,600 million spent by June 2014. This increase was on account of repayment of the USD 600 million external syndicated loan within the FY2014/2015.

The total external and domestic debt service was Ksh 113,544 million and Ksh 139,727 million respectively. As a percentage of the total public debt service, the shares of the external and domestic debt service were 44.8 per cent and 55.2 per cent at June 2015 compared to 25.8 per cent and 74.2 per cent, respectively by June 2014 (Table 1-3)

As shown in Table 1-3, the ratio of public debt service to revenues rose from 16.2 per cent as at end June 2011 to 18.7 per cent by June 2013 and further to 24.6 per cent at end June 2015.

Table 1-3: Kenya, Total Public Debt Service in (Ksh million)

Item Description	June 2011	June 2012	June 2013	June 2014	June 2015
External Principal	21,020	23,954	23,993	25,800	80,214
External Interest	7,035	7,351	11,051	15,600	33,330
Total External Debt Service (TEDS)	28,055	31,305	35,044	41,400	113,544
TEDS as a % of Total Debt Service (TDS)	28.5	27.5	24.1	25.8	44.8
Domestic Interest	70,497	82,339	110,184	119,200	139,727
Domestic Interest as a % of TDS	71.5	72.5	75.9	74.2	55.2
Total Debt Service (TDS)	98,552	113,644	145,228	160,600	253,271
Ordinary Revenue	609,223	690,733	779,436	918,990	1,031,248
Export Earnings (goods only)	511,577	499,737	528,900	523,059	524,992
Total Debt Service as a % of Revenue	16.2	16.5	18.7	17.5	24.6
Total External Debt Service as a % of Exports	5.5	6.3	6.6	7.9	21.6

Source: National Treasury and Central Bank of Kenya

Figure 1-2 shows the trends in domestic and external debt service from 2011 to 2015. External debt servicing has increased from Ksh 28,055 million in June 2011 reaching a level of Ksh 41,400 million in June 2014 and further to Ksh 113,544 million in June 2015.

The external debt service ratio to exports had generally been stable at an average of 6.0 per cent from FY 2010/11 through FY2012/13. However, the ratio of external debt service to exports increased from 5.5 per cent in June 2011 to 7.9 per cent in 2014 and further to 21.6 % in June 2015.

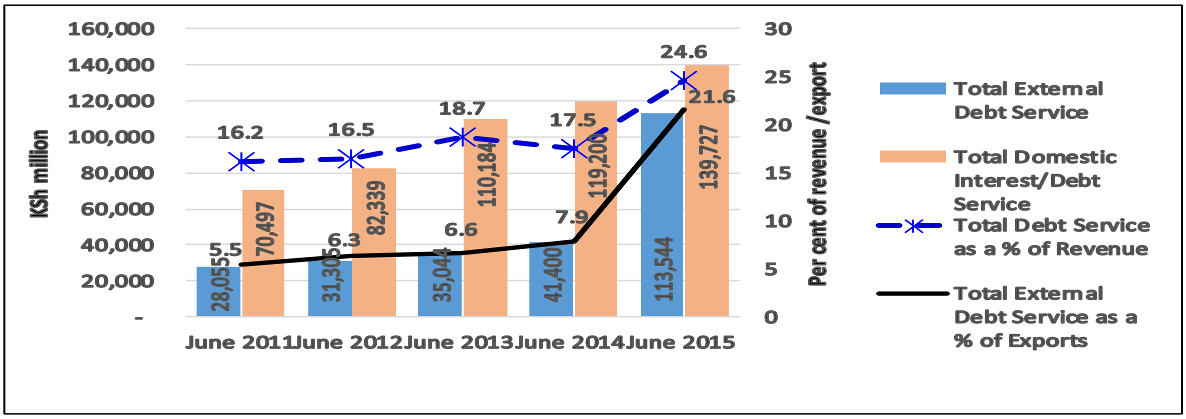


Figure 1-2: Kenya Domestic and External Debt Service, (Ksh million)

Source: National Treasury and Central Bank of Kenya

1.6 Cost/Risk Characteristics of Public Debt

Kenya's cost of public debt is low. Annual interest payment was 3.5 percent of GDP, with interest payment on external debt accounting for 0.6 percent and interest payment on domestic debt at 2.9 percent of GDP. The low interest payment is due to the large share (approximately 80 percent) of external concessional financing in the existing public debt portfolio. At end-FY 2014/15, the weighted average interest rate on the total debt portfolio was 7.3 percent. The weighted average interest rate of external debt portfolio was 2.6 percent, and for the domestic debt it was 11.9 percent.

The exposure to refinancing risk is significant. As at end- FY 2014/15, the main refinancing risk is associated with large domestic debt repayments falling due in FY2015/2016. US$ 4.9 billion (or 35.2 percent) of domestic debt will mature in FY2015/16. Of this amount, 66 percent (or US$ 3.2 billion) consists of maturing T-bills and the remaining US$ 1.7 billion are maturing medium- and long-term T-bonds. 50 percent of total existing domestic debt will mature in the next 3 years. The average time to maturity (ATM) for domestic debt portfolio is 5.3 years. The ATM of external debt portfolio is 12.1 years (See Table 1-4). The long ATM of the external debt portfolio is explained by a large concessional component of the external debt, which has relatively long maturities in the existing portfolio. Nevertheless, there are large refinancing needs falling due in FY2018/19 (US$ 1.3 billion) and in FY2023/24 (US$ 2.5 billion), mainly associated with a repayment of the international bond. The ATM for the total debt portfolio is 8.7 years.

The interest rate risk is similar to the refinancing risk. Although 94 percent of the public debt portfolio has a fixed interest rate, the interest rates of approximately one quarter of outstanding debt will re-fix in FY2015/16. The weighted average time to re-fixing (ATR) for external debt portfolio is 10.9 years. 14.5 percent of outstanding external debt will re-fix in FY2015/16. The main external debt exposure to interest rate re-fixing, is due to variable rate loans coupled with a small share of external debt maturing in the next twelve months. In the case of domestic debt, 100 percent of domestic debt has a fixed interest rate, nevertheless 35.2 percent of the domestic debt portfolio will be re-fixed within a year because of predominance of short-term debt. ATR for the domestic debt is 5.3 years.

Approximately half of the total government debt portfolio is exposed to exchange rate risk. The main exposure to foreign currencies was to the U.S. dollar (60 percent of the total external debt portfolio), followed by the Euro (23 percent), and the GBP and JPK each accounting for 6 percent. Recent depreciation of KSH against the US$ highlights a potential exchange rate risk impact on the budget and the rise in external debt service payment in domestic currency, as well as on the total debt levels. See Figure 2

In sum, the existing debt portfolio as at end-FY2014/15 exhibit low cost but embodies significant risks (See Table 1-4). The stock of debt has low cost due to the predominance of concessional external loans in the existing portfolio. However, the terms of new disbursements are hardening, therefore, the cost is expected to increase over the medium term. Refinancing risk appear to be the risk priority for Kenya, as the volume of T-bills issuance had been increased in the past year, and significant volumes of external commercial debt will come due in FY2018/19.[1] Exchange rate risk is significant, but it is assisted by the low cost of the public debt, which offsets the depreciation risk. Interest rate risk will be addressed if refinancing risk is addressed. Future debt management strategy should therefore strive to reduce refinancing risk, while being mindful of exchange rate exposures, particularly on commercial financial terms.

Table 1-4: Kenya: Cost and Risk Indicators of Existing Debt, as at end-FY2014/15

Risk Indicators		External debt	Domestic debt	Total debt
Central government debt (in billions of KSH)		1,400.7	1,381.2	2,780.0
Central government debt (in billions of USD)		14.2	14.0	28.2
Central government debt as percent of GDP		24.6	24.2	48.8
Present value of debt as percent of GDP		18.5	24.2	42.7
Public and publicly guaranteed debt (in billion USD)		14.7	14.0	28.7
Of which guaranteed debt[2] (in billion USD)		0.5	-	-
Public and publicly guaranteed as percent of GDP		25.4	24.2	49.7
Of which Guaranteed debt as percent of GDP		0.8		
Cost of debt	Interest payment as percent of GDP	0.6	2.9	3.5
	Interest payments as percent of revenues	2.7	12.6	15.3
	Weighted average interest rate in percent	2.5	11.9	7.2
Refinancing risk	Average time to maturity (ATM in years)	12.1	5.3	8.7
	Debt maturing in 1 year as percent of total	2.7	35.2	18.8
	Debt maturing in 1 year as percent of revenues	2.9	37.1	40.0
	Debt maturing in 1 year as percent of GDP	0.7	8.5	9.2
Interest rate risk	Average time to re-fixing (ATR in years)	10.9	5.3	8.1
	Debt re-fixing in 1 year as percent of total	14.9	35.2	25.0
	Fixed rate debt as percent of total debt	87.7	100.0	93.8
Exchange rate risk	Foreign currency debt as percent of total debt			50.3
	Short term foreign currency debt as percent of reserves			5.4

Source: National Treasury.

[1] In October 2015, Kenya contracted a two-year US$750 million syndicated loan at LIBOR plus 520 basis points that will mature in October 2017.

[2] This includes performing guarantees. Non-performing guarantees are included in the central government external debt stock.

The wide average maturity disparities between external and domestic debt portfolio is explained by the different maturity structures: external debt is made up of concessional loans mainly of long maturity; while almost a quarter of domestic debt are short term securities maturing within one year.

CHAPTER TWO: DOMESTIC DEBT

2.1 Total Domestic Debt

Government domestic debt consists of stock of Government securities (Treasury Bills, Treasury Bonds), Pre 1997 Government debt and Government Overdraft at Central Bank of Kenya.

The outstanding stock of domestic debt rose by Ksh 136,117 million (10.6 per cent) to stand at Ksh 1,420,444 million at end June 2015 compared to Ksh 1,284,327 million at end June 2014.

As shown in Table 2-1 and Figure 2-1, the outstanding stock of domestic debt rose by Ksh 136,117 million (10.6 per cent) to stand at Ksh 1,420,444 million at end June 2015 compared to Ksh 1,284,327 million at end June 2014. The increase was mainly attributed to an increase in the stock of Treasury Bonds and Treasury Bills which was used to partly finance the budget deficit and refinancing of matured securities. Overall, the level of domestic debt was partly offset by a repayment of Ksh 1,658 million of the Pre-1997 Government Debt. The CBK Overdraft level decreased by Ksh 744 million from Ksh 37,238 million at end June 2014 to Ksh 36,494 million as at end June 2015.

Table 2-1: Kenya, Trend and Composition of Domestic Debt Outstanding by Instruments in (Ksh million, per cent)

Instrument	June 2011		June 2012		June 2013		June 2014		June 2015	
	Amount	*% of stock*	Amount	*% of stock*	Amount	*% of stock*	Amount	*% of stock*	Amount	*% of stock*
Total Stock of Domestic Debt (A+B)	764,222	100.0	858,830	100.0	1,050,555	100.0	1,284,327	100.0	1,420,444	100.0
A. Government Securities(1-3)	753,929	98.7	848,997	98.9	1,040,274	99.0	1,242,502	96.7	1,381,267	97.2
1) Treasury Bills	126,605	16.6	132,047	15.4	267,211	25.4	299,406	23.3	318,929	22.5
• Banking Institutions	87,736	11.5	75,497	8.8	183,458	17.5	176,450	13.7	217,742	15.3
• Others	38,869	5.1	56,550	6.6	83,753	8.0	122,956	9.6	101,187	7.1
2) Treasury Bonds	595,661	77.9	686,951	80.0	744,174	70.8	914,762	71.2	1,035,662	72.9
• Banking Institutions	294,206	38.5	337,412	39.3	341,047	32.5	436,381	34.0	510,228	35.9
• Others	301,455	39.4	349,539	40.7	403,127	38.4	478,381	37.2	525,434	37.0
3) Pre-1997 Government Debt	31,663	4.1	29,999	3.5	28,889	2.7	28,334	2.2	26,676	1.9
B. Others	10,293	1.3	9,833	1.1	10,281	1.0	41,825	3.3	39,177	2.8
· Of which CBK Overdraft	7,571	1.0	7,257	0.8	6,999	0.7	37,238	2.9	36,494	2.6

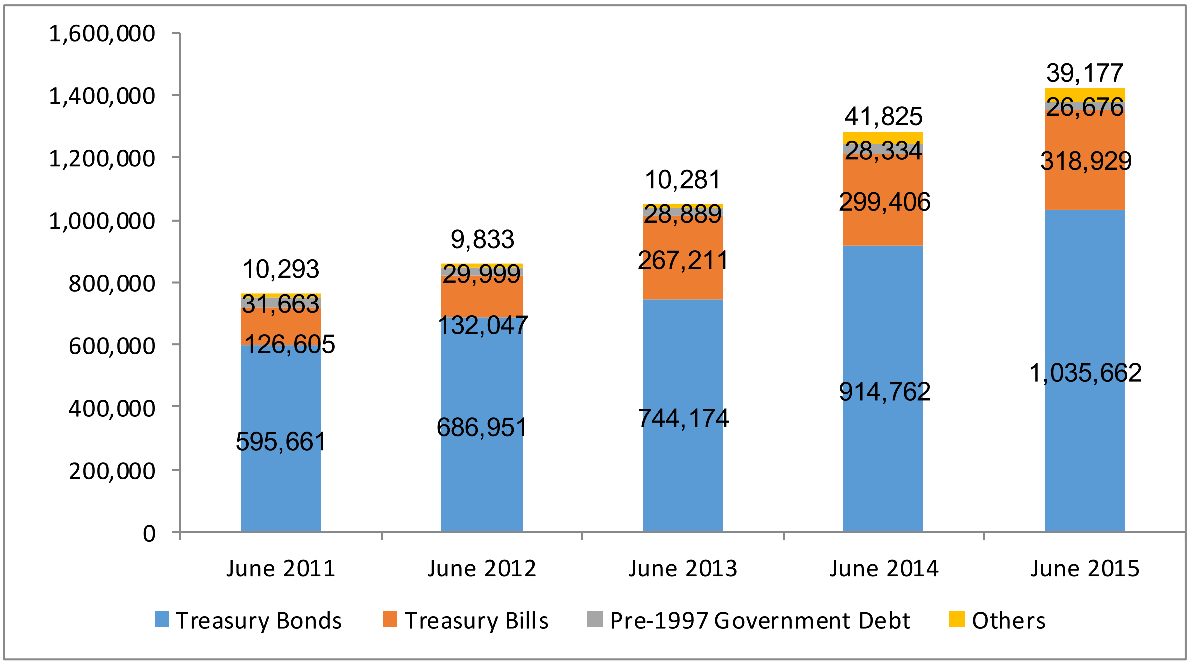
* Others consist of CBK Overdraft to GoK, cleared items awaiting transfer to PMG, commercial bank advances and Tax Reserve Certificates

Source: Central Bank of Kenya

The stock of domestic debt rose from Ksh 764,222 million at end June 2011 to Ksh 1,420,444 million at end June 2015. Further analysis shows that, the stock of Treasury Bonds and Treasury Bills increased from Ksh 595,661 million (77.9% of total debt) and Ksh 126,605 million (16.6%) at end June 2011 to

Ksh 1,035,662 million (72.9%) and Ksh 318,929 million (22.5%) at end June 2015 respectively reflecting the government's debt management strategy to issue benchmark long dated instruments in order to minimize the refinancing risks associated with short term debt securities.

Figure 2-1: Trend in Kenya Total Public Domestic Debt in (Ksh million)



Source: Central Bank of Kenya

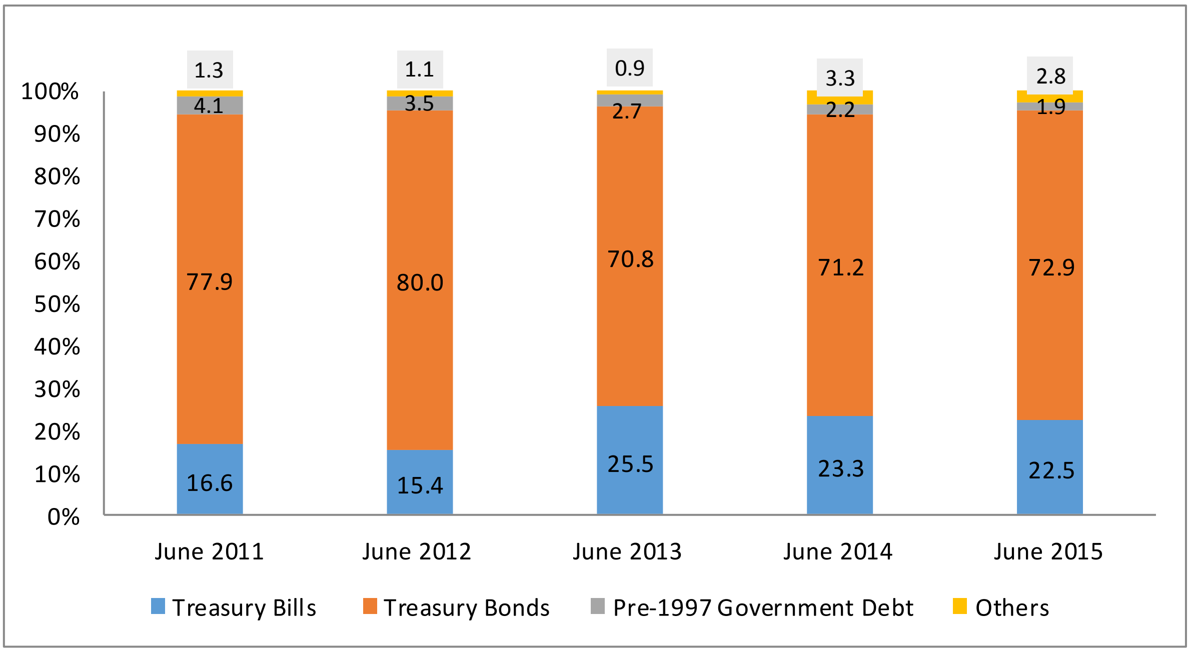
2.2 Domestic Debt by Instrument

Figure 2-2 shows the stock of domestic debt from end June 2011 to end June 2015, broken down by instrument. The composition of domestic debt indicates that the share of Treasury bonds in the portfolio decreased from 80 per cent as end June 2012 to 71.2 per cent as end June 2014, but marginally increased to 72.9 per cent as at end June 2015 while the Treasury bills, which are short term debt, accounted for 22.5 per cent by June 2015 compared to 23.3 per cent by June 2014.

The proportion of Treasury Bonds in total domestic debt increased from 71.2 per cent in 2013/14 to 72.9 per cent in 2014/15 while Treasury Bills declined from 23.3 per cent to 22.5 per cent during the same period.

The proportion of Pre-1997 CBK advances to Government dropped marginally from 2.2 per cent as at June 2014 to 1.9 per cent as at June 2015 due to a net repayment of Ksh 1,658 million made during the FY 2014/15.

Figure 2-2: Kenya domestic Debt by Instrument (%)



Source: Central Bank of Kenya

2.3 Domestic Debt by Holder

The holding of domestic debt by banking sector increased to 55.9 per cent at end June 2015 from 53.2 per cent in June 2014, translating to an absolute holding increase by 16.2 per cent during the same period (Table 2-2 and Figure 2-3).

Commercial banks continued to be largest holders among all investor categories of public domestic debt and held Ksh 730,419 million (51.4 per cent) of the total domestic debt at end of June 2015 compared to Ksh 617,221 million (48.1 per cent) at end June 2014 and Ksh 384,640 million (50.3% of total debt) at end June 2011.

However, the share held by non-bank investors in total domestic debt stock decreased marginally from 46.8 per cent in June 2014 to 44.1 per cent in June 2015 but in terms of actual holding non-bank increased by 4.2 per cent.

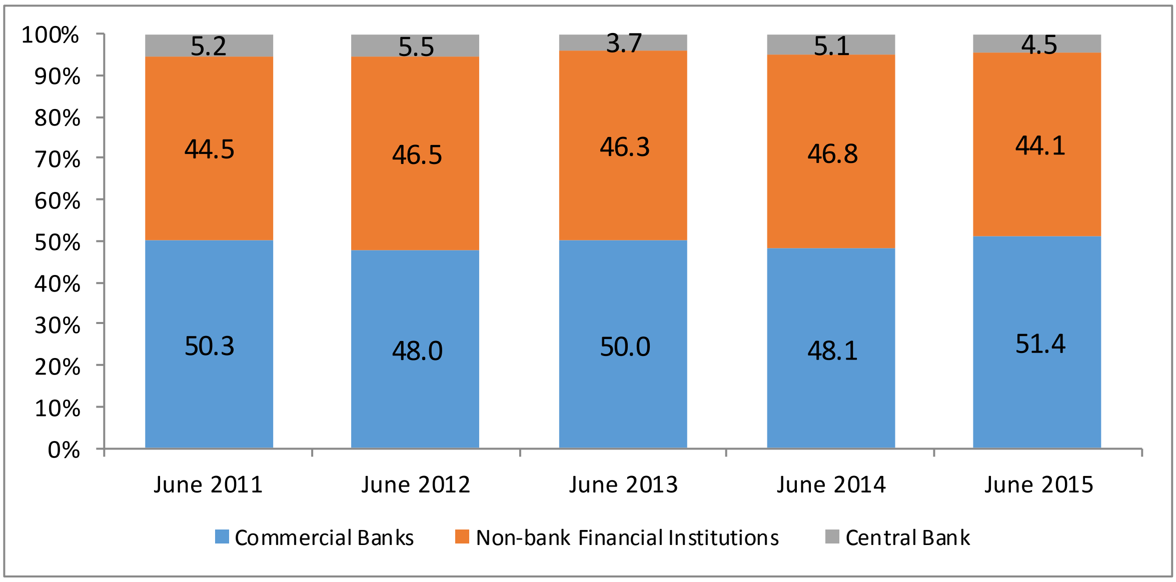
Table 2-2: Kenya Domestic Debt by Holder in (Ksh million)

Holder		June 2011	June 2012	June 2013	June 2014	June 2015
Banks	Amount	424,331	459,250	563,675	682,921	793,754
	% of total	55.5	53.5	53.7	53.2	55.9
• Central Bank	Amount	39,691	47,383	39,170	65,700	63,335
	% of total	5.2	5.5	3.7	5.1	4.5
• Commercial Banks	Amount	384,640	411,867	524,505	617,221	730,419
	% of total	50.3	48.0	50.0	48.1	51.4
Non-banks	Amount	339,891	399,580	486,880	601,406	626,689
	% of total	44.5	46.5	46.3	46.8	44.1
• Non-bank Financial Institutions	Amount	10,013	11,039	13,083	14,925	10,664
	% of total	1.3	1.3	1.2	1.2	0.8
• Other Non-Bank Sources	Amount	329,878	388,541	473,797	586,481	616,025
	% of total	43.2	45.2	45.1	45.6	43.3
Total	Amount	764,222	858,830	1,050,555	1,284,327	1,420,444
	% of total	100	100	100	100	100

Source: Central Bank of Kenya

Figure 2-3 shows that as at end of June 2015, Commercial Banks holdings accounted for 51.4 per cent while Non-bank Financial Institutions (including NBFIs, Insurance Companies, and Pensions Funds including NSSF) account for 44.1 per cent of total public debt. The Central Bank of Kenya's holding accounted for 4.5 per cent of the domestic debt outstanding.

Figure 2-3: Kenya, Public Domestic Debt by Holder (%)



Source: Central Bank of Kenya

2.4 Treasury Bills and Bonds by Holder

2.4.1 Treasury Bills and Bonds by Holder

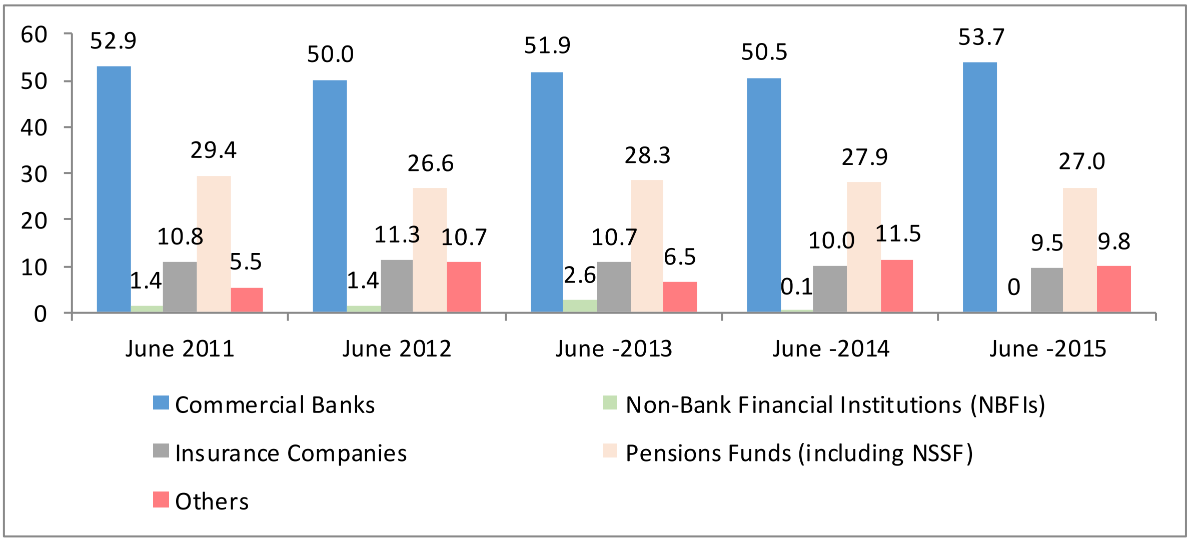
The Commercial Banks were the major contributors in debt financing. Their share of total domestic debt held as Treasury Bills and Bonds reached 51.9 per cent as at end June 2013 but marginally declined to 50.5 per cent in June 2014 and increased to 53.7 per cent as at end of June 2015 (Table 2-3 and Figure 2-4). Pensions Funds (including NSSF) account for over a quarter of total domestic debt (27.9 per cent and 27.0 per cent at end June 2014 and end June 2015 respectively), while the balance is shared by among others, insurance companies and non-bank financial institutions.

Table 2-3: Kenya, Outstanding Stock of Treasury Bills and Bonds by Holders in (Ksh Million, %)

Holder	June 2011		June 2012		June 2013		June 2014		June 2015	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial Banks	381,942	52.9	409,611	50	524,505	51.9	612,772	50.5	727,931	53.7
Non-Bank Financial Institutions (NBFIs)	10,013	1.4	11,731	1.4	26,332	2.6	662	0.1	320	0.0
Insurance Companies	78,280	10.8	92,357	11.3	108,609	10.7	121,024	10.0	127,889	9.5
Pensions Funds (including NSSF)	212,469	29.4	217,697	26.6	285,778	28.3	339,041	27.9	366,303	27.0
Others	39,462	5.5	87,602	10.7	66,161	6.5	140,669	11.5	132,154	9.8
Total	722,266	100	818,998	100	1,011,385	100	1,214,168	100	1,354,597	100.0

Source: Central Bank of Kenya

Figure 2-4: Domestic Debt: Treasury Bills and Bonds by holders (%)



Source: Central Bank of Kenya

2.4.2 Treasury Bills by Holder

As shown in Table 2-4 the stock of Treasury Bills increased by 6.5 per cent from Ksh 299,406 million at end June 2014 to Ksh 318,890 million at end June 2015. The proportion held by commercial banks increased by 23.4 per cent from Ksh 176,437 million at end June 2014 to Ksh 217,703 million at end June 2015.

Pension funds' reduced their holdings in total stock from 22.6 per cent at end June 2014 to 12.8 per cent at end June 2015 with the actual holding declining by 39.6 per cent. On the other hand, proportion in total stock by insurance companies decreased marginally from 6.6 per cent at end June 2014 to 6.5 per cent at end June 2015 while actual holding rose by 5.0 per cent during the period.

Table 2-4: Kenya, Outstanding Stock of Treasury Bills by Holder in (Ksh million, %)

Holder	June 2011		June 2012		June 2013		June 2014		June 2015	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial Banks	87,736	69.0	75,497	57.1	183,458	68.7	176,437	58.9	217,742	68.3
NBFIs	546	0.4	6,297	4.8	5,631	2.1	0	0	0	0
Insurance companies	4,931	3.9	7,220	5.5	14,923	5.6	19,856	6.6	20,849	6.5
Pensions Funds (including NSSF)	25,077	20.0	28,686	21.7	42,917	16.1	67,803	22.6	40,946	12.8
Others	8,315	6.7	14,347	10.9	20,282	7.5	35,310	11.9	39,392	12.4
Total	126,605	100.0	132,047	100.0	267,211	100.0	299,406	100.0	318,929	100.0

Source: Central Bank of Kenya

2.4.3 Treasury Bonds by Holder

Table 2-5 shows that the outstanding Treasury Bonds increased by 13.2 per cent from Ksh 914,762 million at end June 2014 to Ksh 1,035,662 million at end June 2015. The holdings by commercial banks increased by 16.9 per cent during 2013/14 to 2014/15 period and continue to dominate at 49.3 per cent. Holdings by Pension funds increased to 31.4 per cent at end June 2015 from 29.7 per cent of total outstanding bonds at end June 2014 though there was a growth of 20.0 per cent in absolute holding.

Table 2-5: Outstanding Stock of Treasury Bonds by Holder in (Ksh million, %)

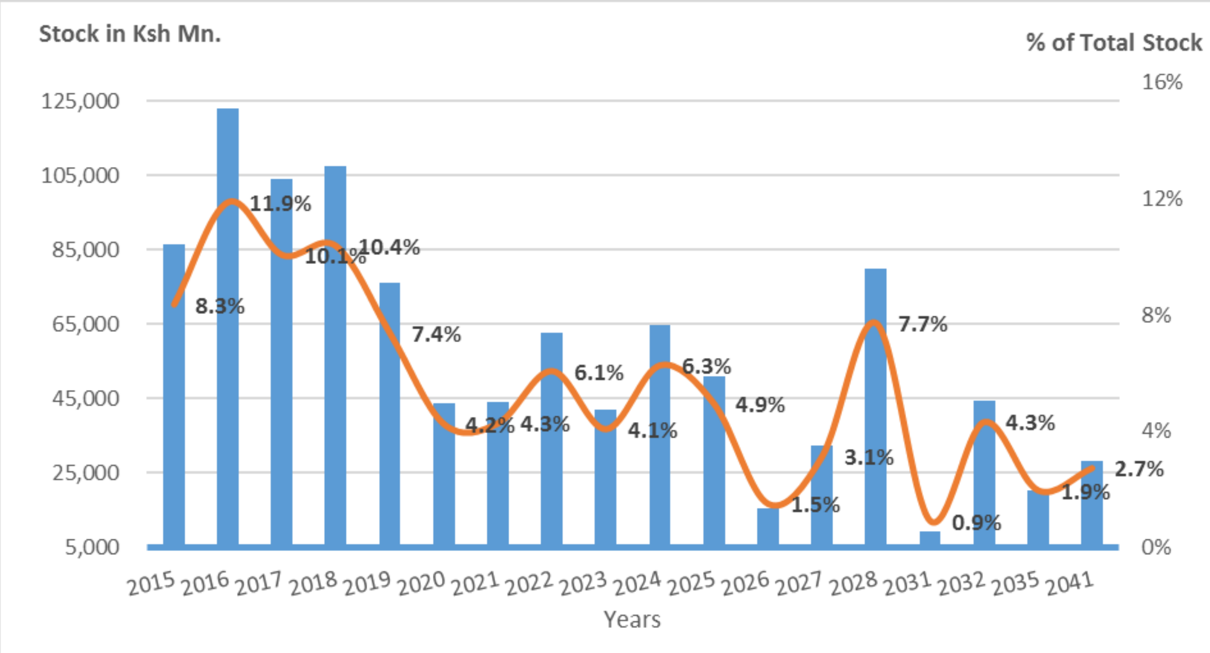
Holder	June 2011		June 2012		June 2013		June 2014		June 2015	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial Banks	294,206	49.4	334,114	48.6	341,047	45.8	436,335	47.7	510,228	49.3
NBFIs	9,467	1.6	5,434	0.8	20,701	2.8	662	0.1	320	0.0
Insurance Companies	73,349	12.3	85,137	12.4	93,686	12.6	101,168	11.1	107,040	10.3
Pensions Funds (including NSSF)	187,392	31.5	189,011	27.5	242,861	32.6	271,238	29.7	325,357	31.4
Others	31,147	5.2	73,255	10.7	45,879	6.2	105,359	11.5	92,717	9.0
Total	595,661	100	686,951	100	744,174	100	914,762	100	1,035,662	100.0

Source: Central Bank of Kenya

2.5 Outstanding Treasury Bonds by Maturity

Figure 2-5 shows the domestic Treasury Bonds debt stock outstanding by maturity. The outstanding bonds across the various remaining maturities amounted to Ksh 1,035,662 million at the end of June 2015 compared to Ksh 914,762 million as at end June 2014. About 48 per cent of outstanding government bonds will be retired in the next 5 years (Figure 2-5). There is rollover risk in the medium term as demonstrated by the several redemption spikes falling in 2016 (11.92% of outstanding bond stock), 2017 (10.1%) and 2018 (10.4%).

Figure 2-5: Outstanding Government Bonds by Maturity



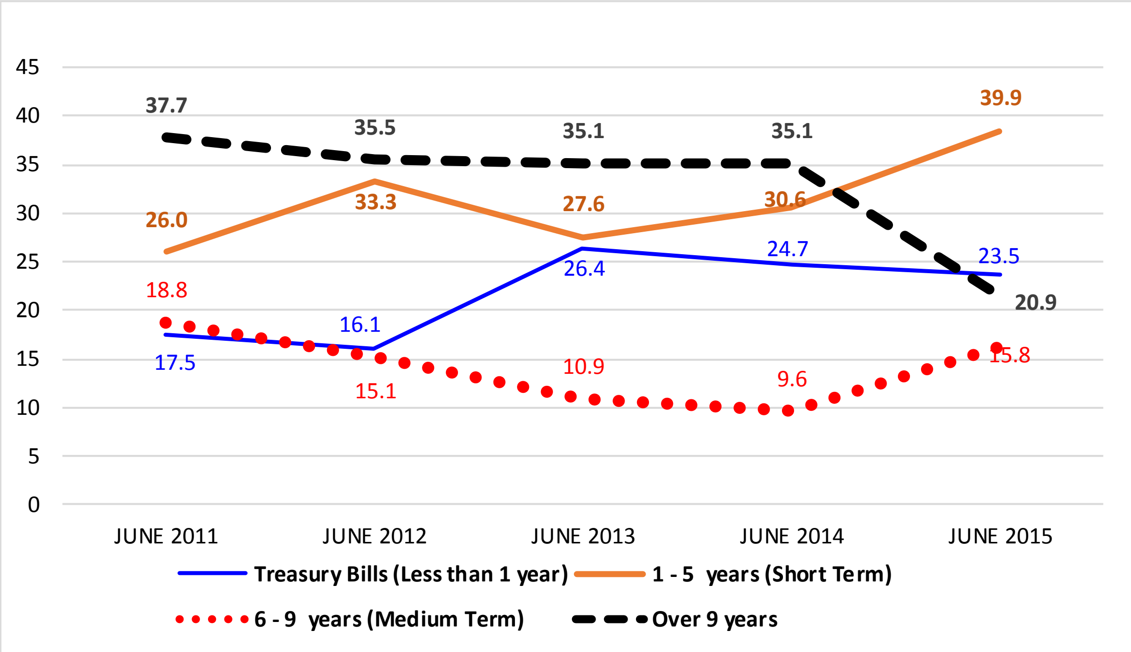
Source: Central Bank of Kenya

2.6 Treasury Bills and Bonds by Tenor

The original maturity structure of the domestic debt as at end of June 2015 shows that, Treasury Bills accounted for a quarter (23.5 per cent), while the Treasury Bonds debt portfolio with original maturities of 1-5 years and 6-9 years constituted 39.9 per cent and 15.8 per cent respectively. Treasury Bonds with original maturity of 10 years and longer account for 20.7 per cent (Figure 2-6).

During the 2014/15 financial year, the proportion of the outstanding 91 day and 182 day Treasury Bills accounted for 1.4 per cent and 5.6 per cent respectively (compared to 4.5 per cent and 7.3 per cent in 2013/14 respectively). The stock of 364-day Treasury Bills accounted for 16.6 per cent in 2014/15 compared to 12.8 per cent in 2013/14. This reflects increased investor preference for the 364-day Treasury Bills during the period under review.

Figure 2-6: Kenya, Trends in Outstanding Government Securities by Tenor (%)



Source: Central Bank of Kenya

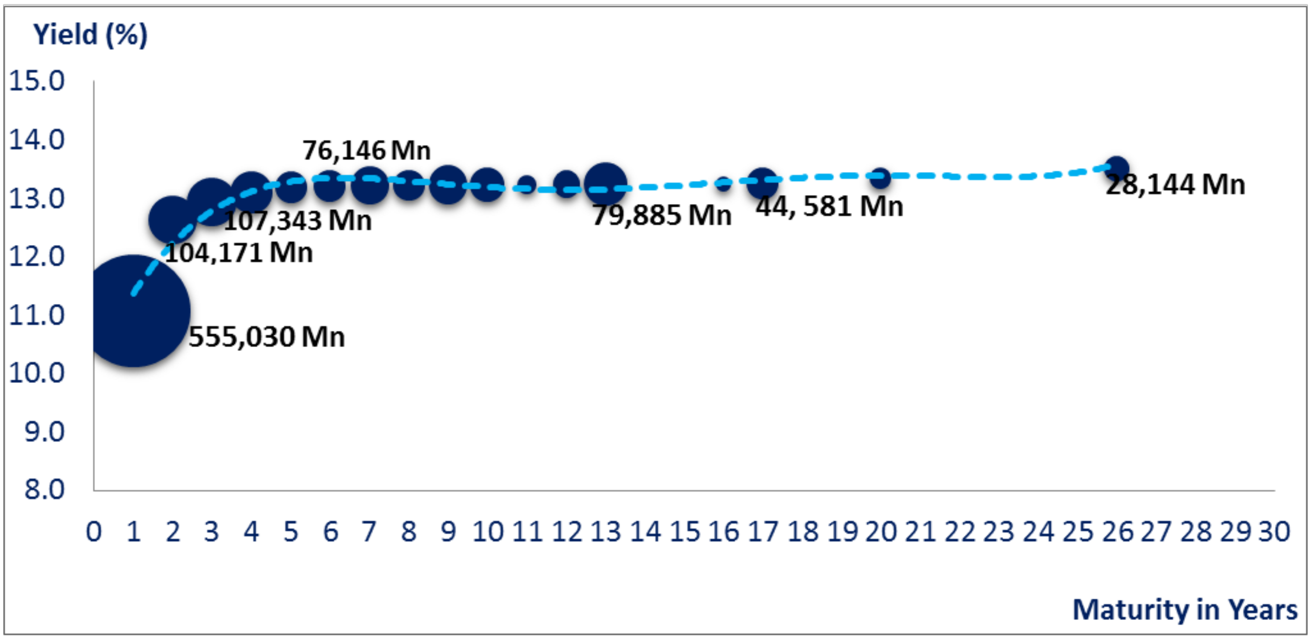
Trends in domestic debt outstanding by maturity of instruments show that while the dominance of the debt outstanding instruments with more than nine years is evident between June 2011 and June 2014, a significant decline was visible by June 2015 (20.9%). However, the 6 – 9 years instruments in the portfolio which showed a decline from 18.8 per cent by end June 2011 to 9.6 per cent by end June 2014 recovered to reach 15.8 per cent at end June 2015 (Figure 2-6).

There was a marked shift in composition of domestic debt as the Treasury bills increased to 26 per cent of total domestic debt as at end June 2013 compared with 16.1 per cent as at end June 2012. This may be a pointer that investors showed appetite for short-term instruments in recent years. A rise in share of short maturity profile of the portfolio has implications including increased refinancing risks.

2.7 Treasury Bills and Bonds by Time to Maturity

Figure 2-7 on maturity distribution indicates an increase in concentration of Government securities stock at the short to medium term segment of the yield curve. There was a shift in the proportion of bonds in the portfolio increasing marginally to 76.5 per cent as at end June 2015 from 75.3 per cent at end June 2014 while Treasury bills decreased to 23.5 per cent from 24.7 per cent during the same period.

Figure 2-7: Stock of Treasury bills and bonds in Ksh Billions along the Yield Curve as at 30 June 2015



Source: Central Bank of Kenya

2.8 Infrastructure Bonds (IFBs) Program

The issuance of Infrastructure Bonds in Kenya began in February 2009 to mobilize resources for specific projects in roads, energy and water sectors to support economic development.

The primary objective of the Government in issuing the Infrastructure Bonds was to set precedence to State Owned Enterprises (SOEs) and Local Authorities (LAs) with strong balance sheets to tap into the capital markets to finance their capital requirements and deliver on their mandate effectively. However, not much activity has been registered and Government has been the main issuer.

To date, a total of Ksh 233.5 billion (successful bids at cost) has been raised through the sale of eight (8) IFBs as reflected in Table 2-6. In 2014/2015, two (2) IFB (IFB1/2014/12, IFB/2015/12) were issued.

Table 2-6: Performance of Infrastructure Bond (IFB) at Primary Market Auction (Ksh million)

Bond Issue Number	Date of Issue	Offer Amount	Bids Received F.V.	Successful Bids		Coupon Rate (%)	Successful Average Rate (%)
				Cost	F.V.		
IFB 1/2009/12	23-02-09	18,500	26,884	10,588	11,244	12.500	13.505
IFB 2/2009/12	07-12-09	18,500	44,121	18,400	18,898	12.000	12.537
IFB 1/2010/8	01-03-10	14,500	35,273	16,042	15,908	9.750	9.579
IFB 2/2010/9	30-08-10	31,600	37,362	30,585	32,872	6.000	7.293
IFB1/2011/12	3-10-11[3]	35,850	38,999	37,190	43,447	12.000	16.640
IFB1/2013/12	30-09-13[4]	36,000	37,629	35,941	38,364	11.000	12.363
IFB1/2014/12	27-10-14[5]	35,000	41,003	35,015	35,481	11.000	11.263
IFB1/2015/12	30-03-15[6]	50,000	76,394	49,712	51,192	11.000	11.556
Grand Total				233,473	247,406		

Source: Central Bank of Kenya

2.9 Average Interest Rates on Treasury Bills

Figure 2-8 shows that the 91-day Treasury bill rate declined by 160 basis points from 9.9 per cent in June 2014 to 8.3 per cent in June 2015. The average interest rate for the 182-day Treasury bill decreased by 10 basis points from 10.7 per cent to 10.6 per cent during the period while the average for the 364-day Treasury bill remained at 11.0 percent in June 2015.

The 91-day and 182-day Treasury Bills average rates act as reference interest rates for pricing other financial products, making adjustments to commercial banks' deposit and lending rates as well as structuring of investment portfolios.

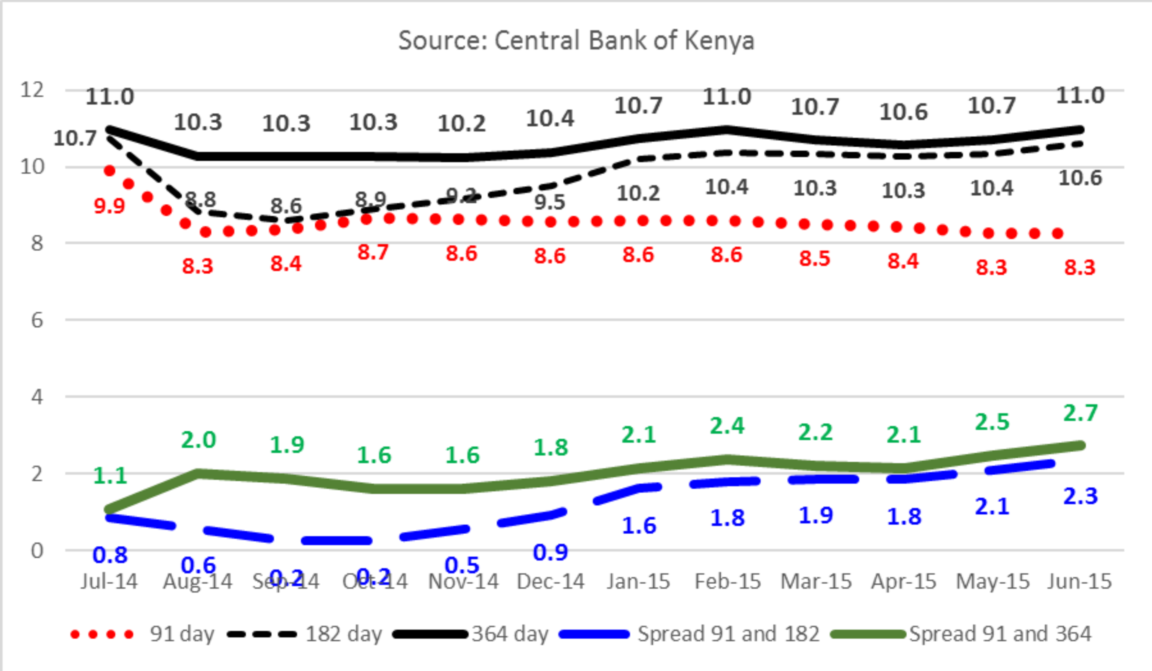
[3] This bond was reissued on tap on 7-Nov-11, 5-Dec-11, 2-Jan-12, 6-Feb-12 and 27-Feb-12. The bond will be amortized on 28-Sep-15, 23-Sep-19 and 18-Sep-23

[4] This bond was reissued on tap on 28-Oct-13. The bond will be amortized on 25-Sep-17, 20-Sep-21 and 15-Sep-25

[5] This bond was reissued on tap on 3-Nov-14, 10-Nov-14 and 17-Nov-14. The bond will be amortized on 22-Oct-18, 17-Oct-22 and 12-Oct-26

[6] This bond was reissued on tap on 13-Apr-15. The bond will be amortized on 22-Mar-21, 18-Mar-24 and 15-Mar-27

Figure 2-8: Interest Rates on Treasury Bills, July 2014- June 2015

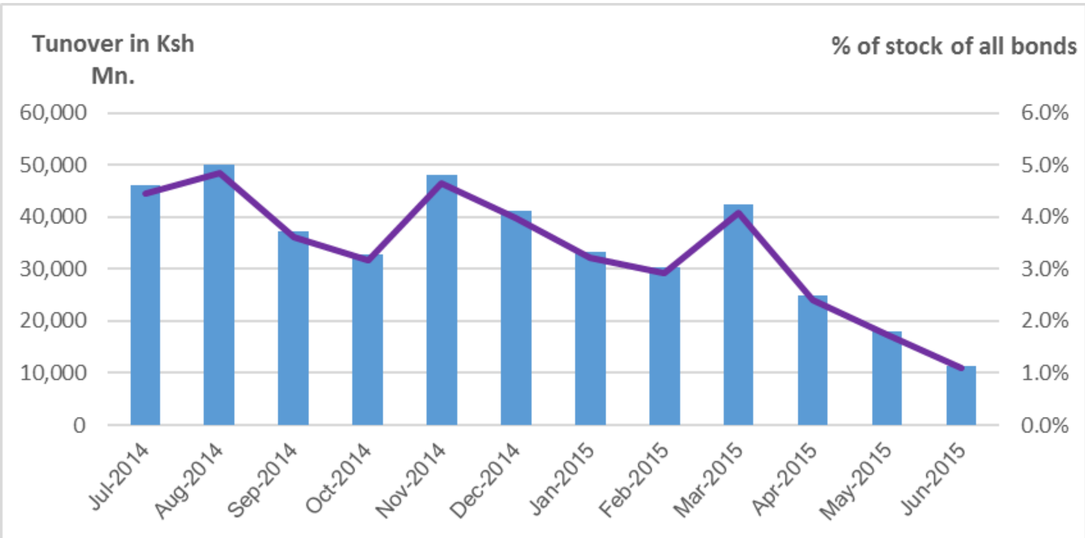


Source: Central Bank of Kenya

2.10 Government Securities Trading

Government bonds' trading was vibrant in July, August, November and December of 2014 and March 2015 of the financial year with notable decline in market activity in the other months (Figure 2-9).

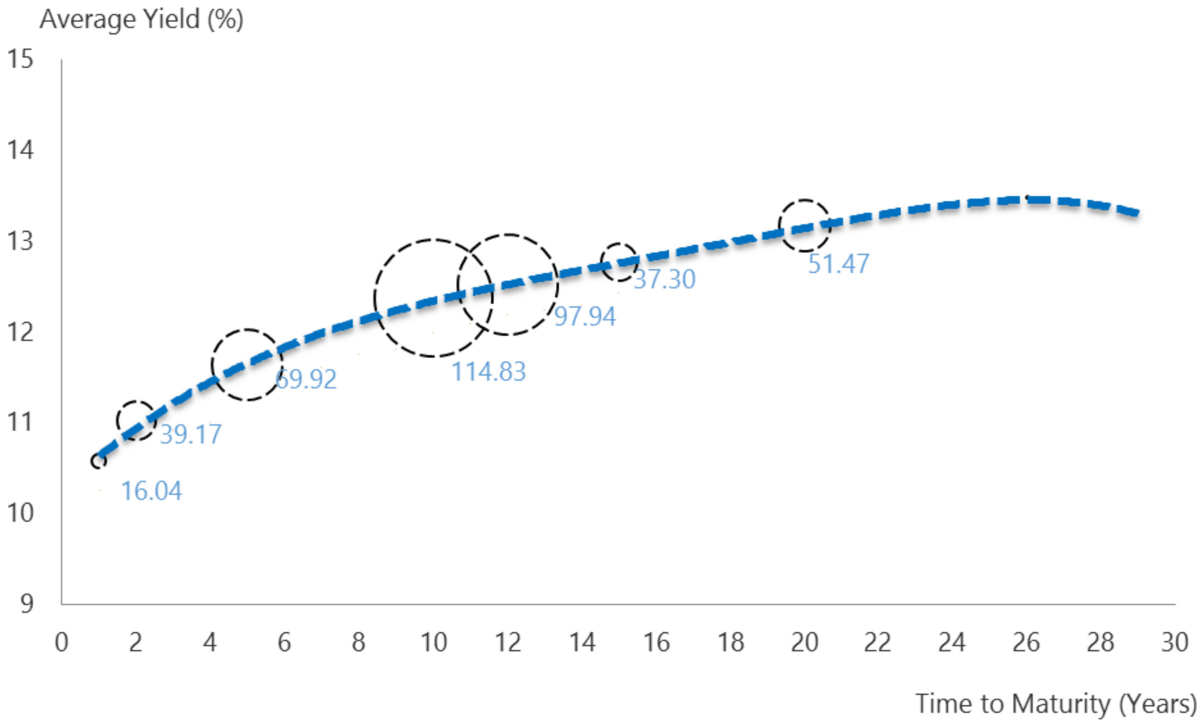
Figure 2-9: Bonds Trading, July 2014 - June 2015



Source: Central Bank of Kenya

Figure 2-10 shows that trading activity was concentrated in the short to medium segments of the yield curve with the bulk of it in benchmark maturities of 2, 5, 10 and 15 years. Infrastructure Bonds also traded actively during the year. This outcome is a reflection of positive gains from the implementation of the Benchmark Bonds and Infrastructure Bonds programs.

Figure 2-10: Treasury Bonds Turnover (Kshs billion) along the Average Yield Curve during FY 2014-2015



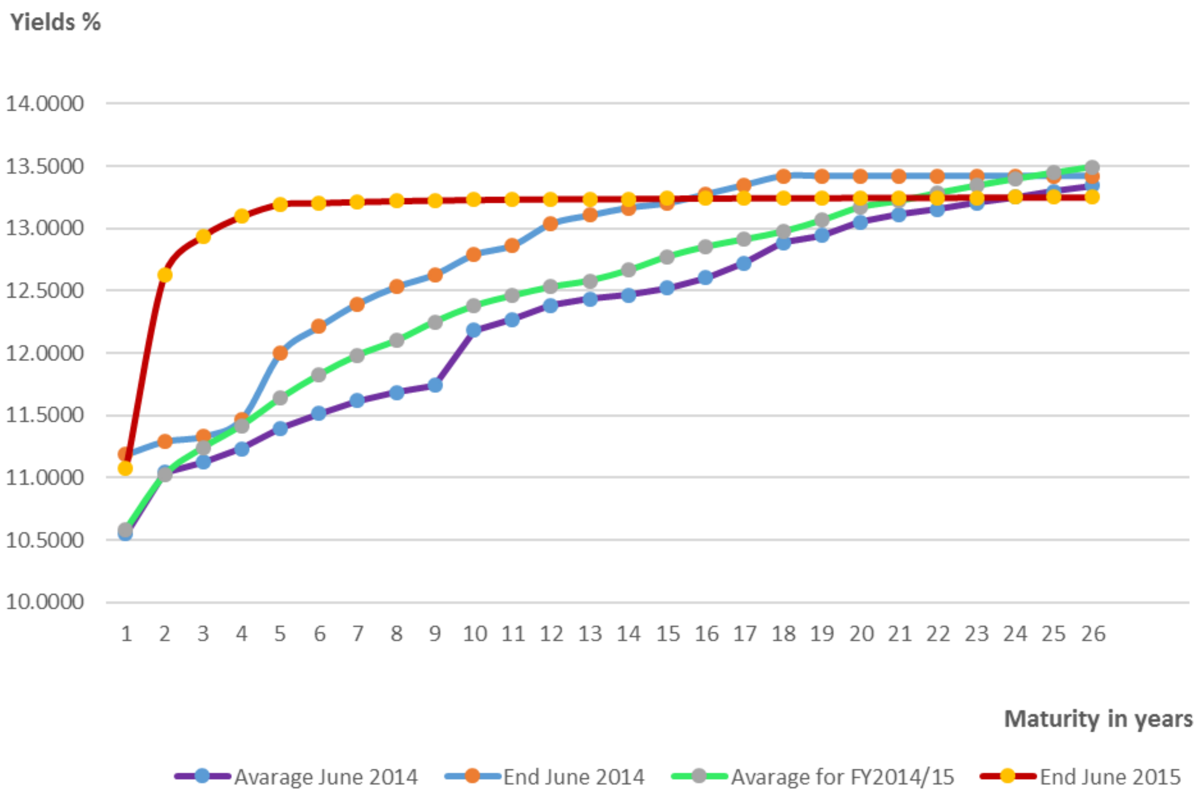
Source: Central Bank of Kenya

2.11Government Securities Yield Curve

The Government securities yield curve depicts a normal trend as at end June 2015 but steady shift is noted during the financial year from June 2014 position, indicating stability of pricing along the maturity profile (Figure 2-11).

This movement is also in line with trends in inflation during the year which reflected on the confidence and certainty of the market. The yield curve reflects the risk premium associated with the uncertainty about the future rate of inflation and the risk this poses to the future value of investment.

Figure 2-11: Government of Kenya Securities Yield Curve, June 2015



Source: Central Bank of Kenya

2.12Domestic Interest Payments

Trend analysis shows a gradual increase in domestic debt service payments from Ksh 70,497 million as at end of June 2011 to Ksh 119,200 million as at end June 2014. The cumulative interest and other charges on domestic debt service for FY 2014/15 amounted to Ksh 139,727 million by June 2015 (Table 2-7). The increase in interest payments was occasioned by increase in domestic debt stock.

As at end of June 2015, Treasury Bonds and Treasury Bills debt service accounted for 78.0 per cent and 17.7 per cent respectively of domestic debt service. The ratios of domestic interest payment to domestic revenue and expenditure have marginally changed during the period under review.

Table 2-7: Kenya, Trends in Domestic Interest Payments and Ratios in (Ksh million)

Type of Debt	June 2011	June 2012	June 2013	June 2014	June 2015
Treasury Bills	7,369	11,055	19,505	26,897	24,714
Treasury Bonds	58,162	64,620	82,560	85,758	108,948
CBK Commission	3,000	3,000	3,000	3,106	3,000
Pre - 1997 Debt	1,171	0	1,698	1,138	825
Others (Overdraft)	795	3,664	3,421	2,301	2,240
Total	70,497	82,339	110,184	119,200	139,727
Ratios (Per cent)					
Domestic Interest/Revenue	11.6	11.9	12.7	13.0	13.5
Domestic Interest/Expenditure	8.7	8.7	9.2	9.2	8.5
Domestic Interest/GDP	2.0	2.1	2.5	2.4	2.9
Domestic Interest/Total Interest	90.9	91.8	90.9	88.4	80.7

Source: National Treasury

CHAPTER THREE: EXTERNAL DEBT

3.1 Total External Debt

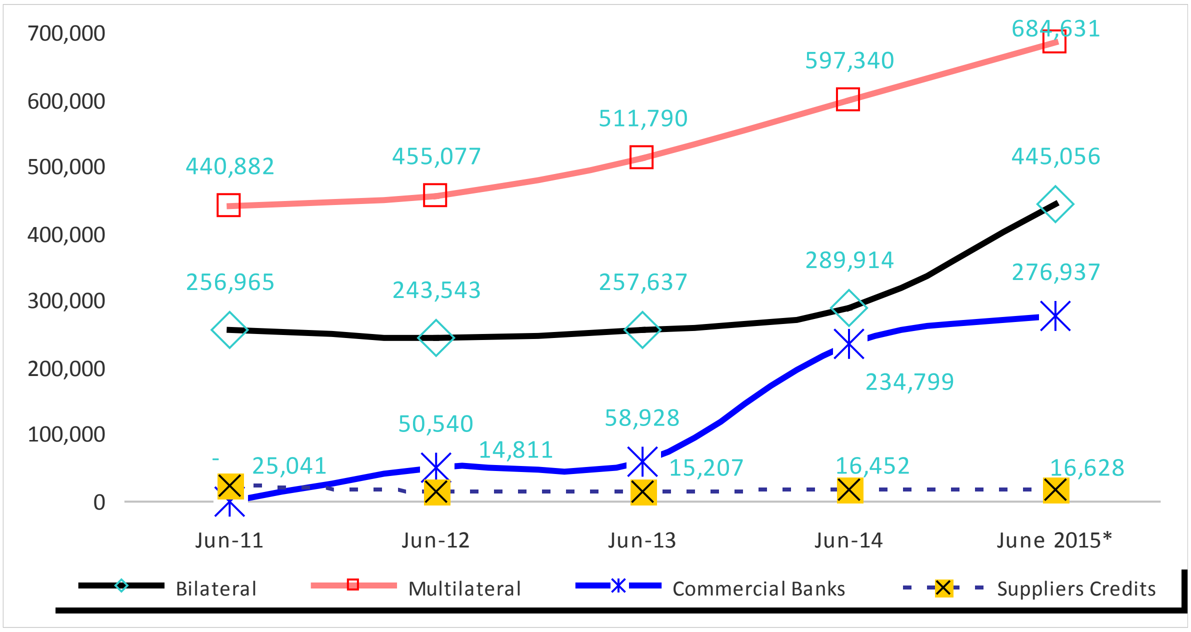
The external debt stock has continued to rise over the last five years. Total public and publicly guaranteed external debt increased from Ksh 1,138,505 million in June 2014 to Ksh 1,423,252 million in June 2015, an increase of 25 per cent (Table 3.1 and Figure 3-1) which was largely attributed to disbursements from the debut International Sovereign Bond, disbursements from multilateral and bilateral creditors as well as foreign exchange rate movements between the different currencies in the external loan portfolio. Publicly guaranteed debt, which accounted for 4.0 per cent of total external debt as at June 2014, declined to 3.1 per cent at end June 2015 (bilateral creditors accounted for 89.9 per cent of the guaranteed debt and multilateral, 10.1 per cent at end June 2015).

Table 3-1: External Debt Stock by Creditor Type in (Ksh million)

Creditor type	Jun-2011	Jun-2012	Jun-2013	Jun-2014	June 2015
Bilateral	215,035	199,950	217,970	248,636	405,562
Multilateral	436,838	451,287	507,920	593,397	680,192
Commercial Banks	-	50,540	58,928	234,799	276,937
Suppliers Credits	25,041	14,811	15,207	16,452	16,628
Sub-Total	676,914	716,588	800,025	1,093,284	1,379,319
Memorandum item (guaranteed debt)					
Bilateral	41,930	43,593	39,667	41,278	39,495
Multilateral	4,044	3,791	3,870	3,943	4,439
Sub-Total	45,974	47,383	43,537	45,221	43,934
Total External (including public guaranteed debt)	722,888	763,971	843,562	1,138,505	1,423,252

Source: National Treasury

Figure 3-1: Kenya, External Debt Stock by Creditor Type (including publicly guaranteed debt) (Ksh Million)



Source: National Treasury

3.2 The Structure of External Debt, including Publicly Guaranteed Debt

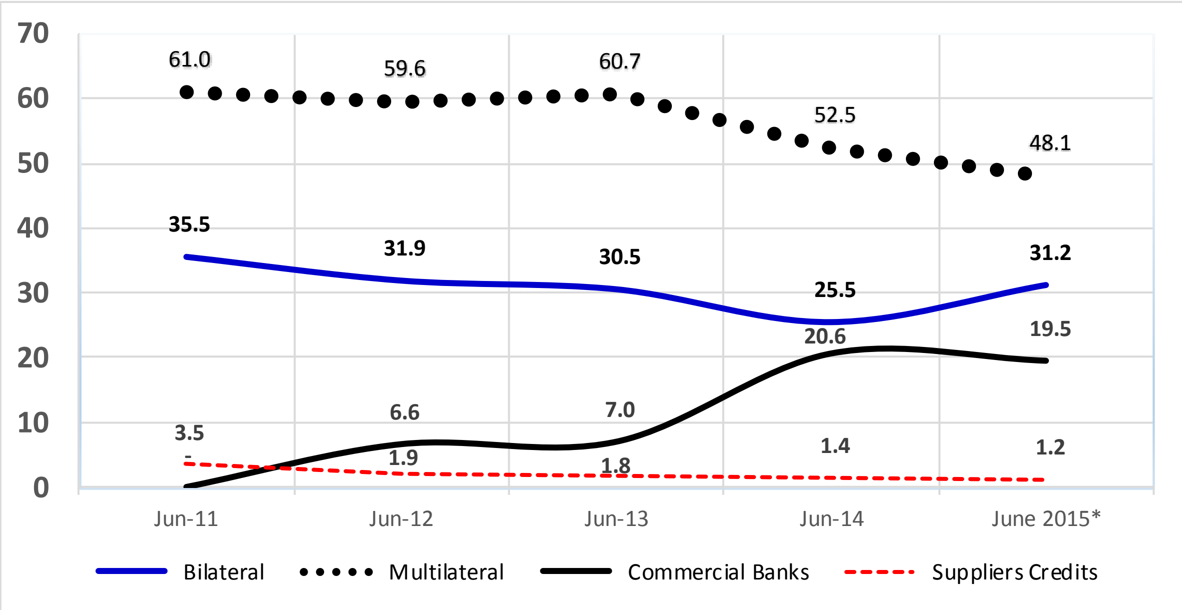
3.2.1 External Debt by Creditor Category

The trend analysis of the external debt portfolio structure between end June 2011 and end June 2015 reveal that the share of multilateral debt decreased from 61.0 per cent as at end June 2011 to 48.1 per cent as at end June 2015 (Figure 3-2).

Debt owed to the bilateral creditors was also on a declining trend from 35.5 per cent at June 2011 to 25.5 per cent in June 2014, and rose to 31.3 per cent as at end June 2015. Debt owed to suppliers' credit ranged between 3.5 per cent as at June 2011 and 1.2 per cent as at June 2015.

The share of debt owed to commercial creditors increased from 6.6 per cent as at June 2012 to 20.6 per cent as at June 2014 due to tapping of the debut International Sovereign Bond, but marginally declined to 19.5 per cent as at June 2015 mainly attributable to repayment of the syndicated commercial loan amounting to Ksh 53,025 million (USD 600 million) during the 2014/15 financial year.

Figure 3-2: Trends in External Debt Stock by broad creditor category in percentage (including Publicly Guaranteed Debt)



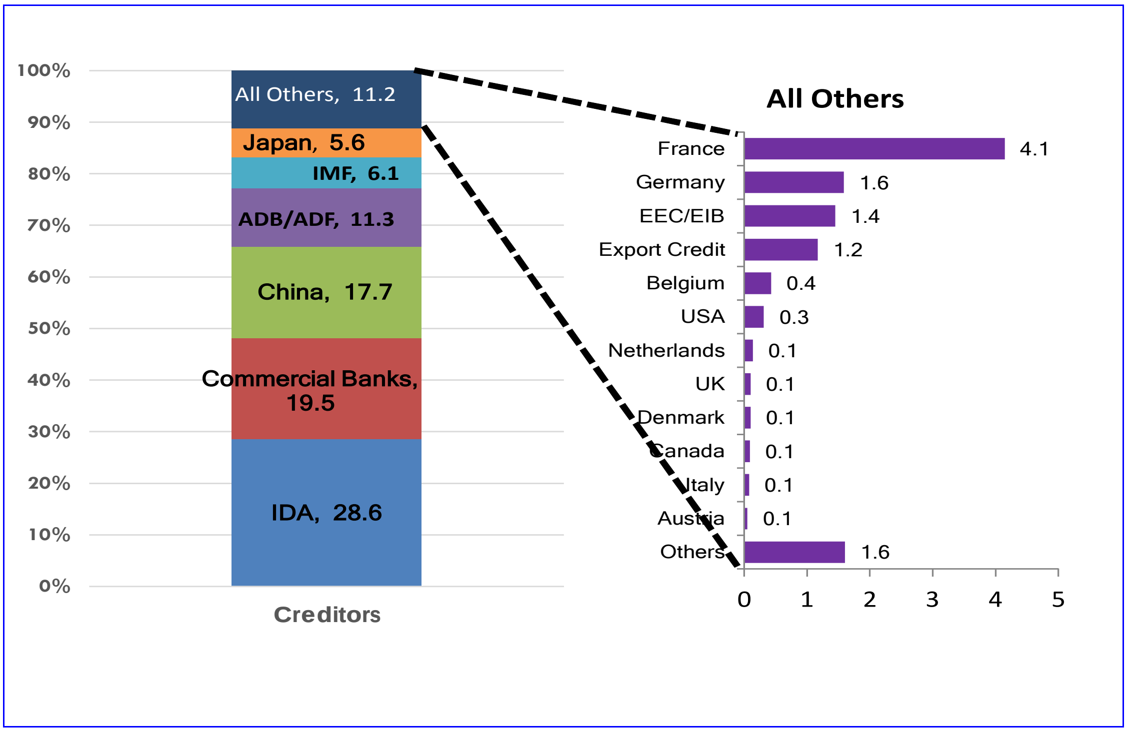
Source: National Treasury

3.2.2 External Debt by Major Creditors

As at June 2015, the World Bank (IDA) was the leading creditor in the external debt portfolio at 28.6 per cent of total external debt, followed by commercial creditors (19.5 per cent) and China at 17.7 per cent (Figure 3-3). Among major multilateral and bilateral creditors are AfDB/ADF, Japan, France and IMF.

A significant portion of the external debt consists of highly concessional loans characterised by long repayment periods with low interest rates. These features have a strong influence on the overall cost and risk exposure of Kenya's existing external debt portfolio.

Figure 3-3: External Debt (including Public Guaranteed Debt) by Major Creditors, June 2015



Source: National Treasury

3.2.3 Currency Structure of External Debt

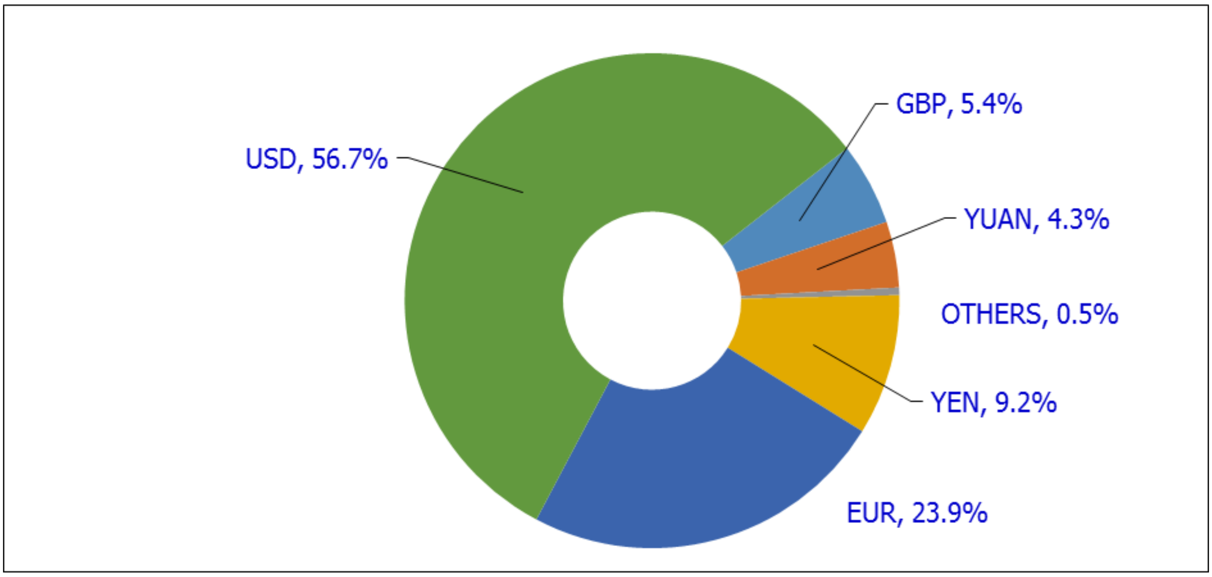
The United States Dollar was the dominant currency of the external debt stock accounting for 56.7 per cent followed by the Euro at 23.9 per cent, Japanese Yen at 9.2 per cent, and Sterling Pound at 5.4 per cent and the Yuan at 4.3 per cent at end June 2015.

The external debt stock by currency composition as at end of June 2015, show that the portfolio was mainly made up of five major currencies, namely: United States Dollar (USD), Euro, Sterling Pounds (GBP), Japanese Yen and Chinese Yuan.

Figure 3-4 shows that United States Dollar was the dominant currency accounting for 56.7 per cent of the external debt stock followed by the Euro at 23.9 per cent, Japanese Yen at 9.2 per cent, and Sterling Pound at 5.4 per cent and the Yuan at 4.3 per cent at end June 2015. Other currencies account for the remainder of 0.5 per cent.

The currency mix, however, is not an outcome of a deliberate debt management strategy but a reflection of the source of funding. A diversified currency acts as a measure against exchange rate risks on a country's external debt, and a deliberate effort needs to be made in choice of Kenya's currency mix. .

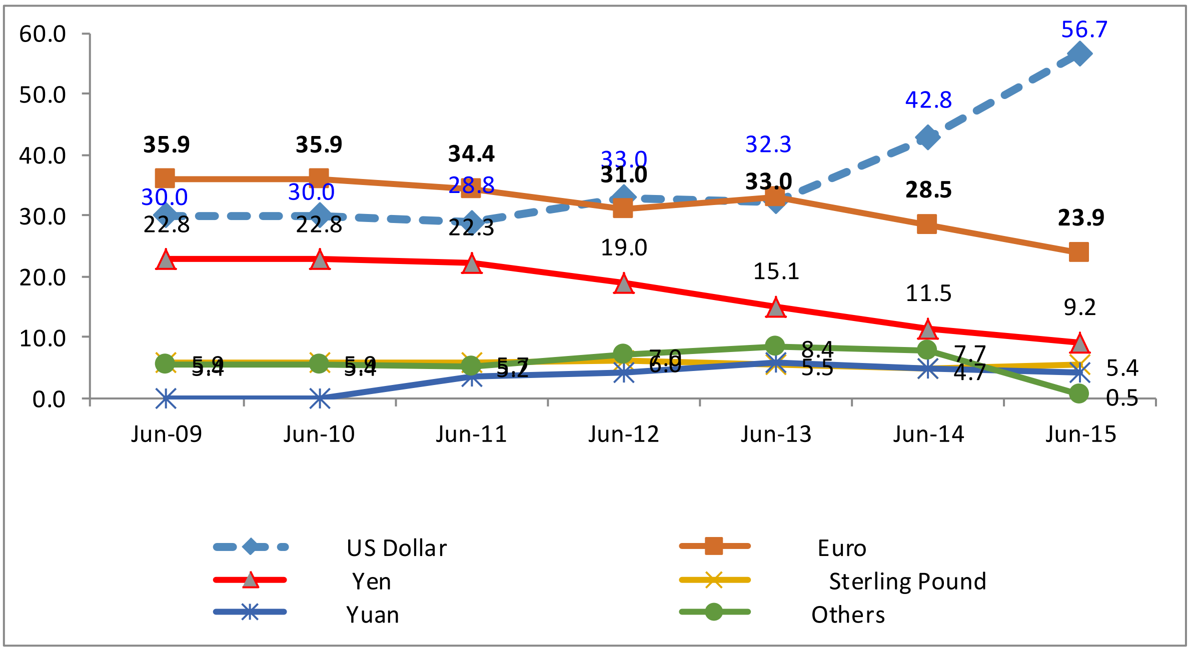
Figure 3-4: External Debt Stock by Currency Composition as at end of June, 2015 (%)



Source: National Treasury

Figure 3-5 shows the trends in external debt by currency. It is seen that the Euro which was the dominant currency in 2010 at 35.9 per cent has by end June 2015 lost its position to the US Dollar. This is attributed to the US Dollar 2,750 million Sovereign Bond issued in 2014.

Figure 3-5: Trends in External Debt by Currency

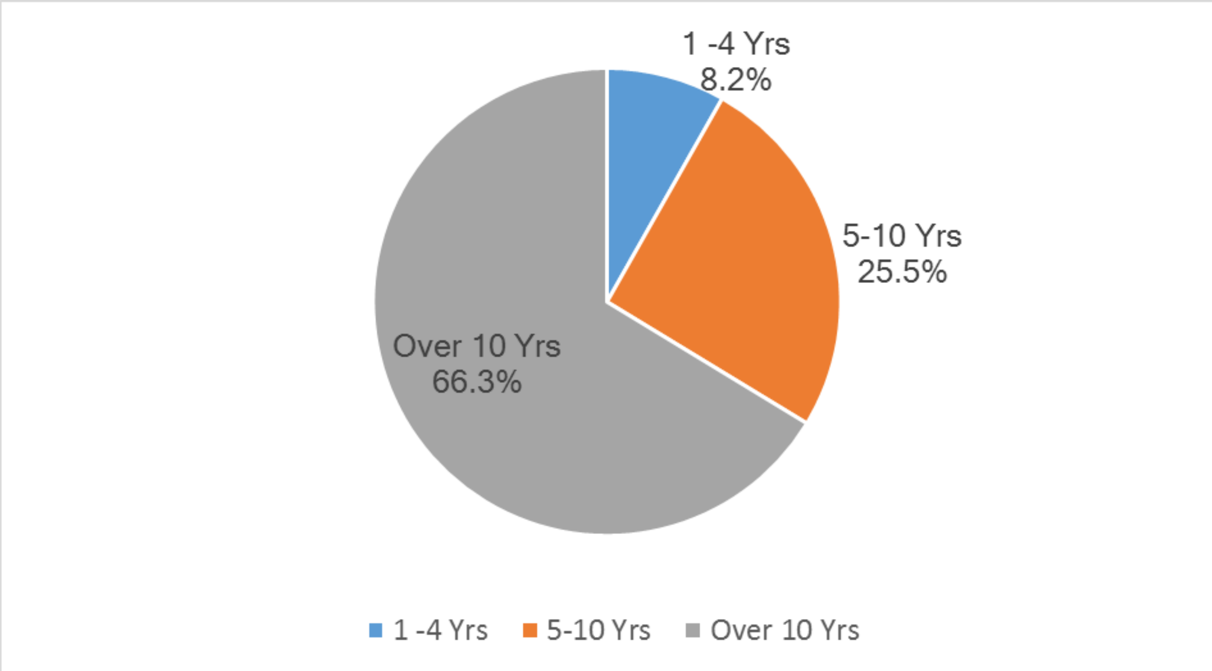


The total external debt at end June 2015 comprised 99.5 per cent in 5 currencies namely USD, Euro, Japanese Yen, Sterling pound and Chinese Yuan. As at end of June 2015, the share of Euro denominated external debt declined to 23.9 per cent from 28.5 per cent while USD denominated debt increased to 56.7 per cent from 42.8 in the previous year.

3.3 Maturity Structure

By end of June 2015, significant external debt had long maturity of more than 10 years (66.3 per cent) indicating that the country's external debt is long term (Figure 3-6). The fact that only 8.2 per cent of the debt portfolio will mature within 4 years reflects a low refinancing risk. However, a look at Table 3-2 reveals that the external debt with maturity of more than 10 years has been declining. The longer the average term-to-maturity, the more time government has to repay its debt obligations.

Figure 3-6: External Debt by Maturity, June 2015



Source: National Treasury

Table 3-2: Kenya, Maturity Structure of Outstanding External Debt (%)

Remaining Maturity	June 2011	June 2012	June 2013	June 2014	June 2015
1 -4 years	2.4	6.6	7.9	14.7	8.2
5-10 years	20.7	15.8	16.9	22.9	25.5
Over 10 years	76.9	77.6	75.3	62.4	66.3

Source: National Treasury

3.3.1 Average Terms of New External Loan Commitments

Average maturity is frequently used as an ordinary benchmark for assessing refinancing risks. The average maturity, grace period and average interest rate on new external loan commitments as at the end of June 2015 were 21 years, 6.4 years and 2.5 per cent respectively. Overall, these borrowing terms are favourable to the country and are in line with the Government's external debt strategy of contracting external loans on highly concessional or "soft" terms.

As shown in Table 3-3, the average grant element of new external loan commitments was 69.8 per cent in 2010/11 compared to 63.2 per cent by end 2014/15, indicating hardening of borrowing terms.

Table 3-3: Average Terms of New External Loan Commitments

Terms	June 2011	June 2012	June 2013	June 2014	June 2015
Average Maturity (years)	26.6	26.3	33.7	18.1	21.0
Grace Period (years)	8.1	6.2	8.0	6.2	6.4
Average Interest Rate (%)	0.8	0.8	1.2	2.6	2.5
Average Grant Element (%)	69.8	65.8	68.6	63.9	63.2

3.4 External Debt Service

Table 3-4 shows the breakdown of external debt service payments by creditor category for the period end of June 2011 to end of June 2015. The total principal and interest payments on public external debt increased from Ksh 41,400 million as at end June 2014 to Ksh 113,544 million as at end June 2015 representing an increase of Ksh 72,122 million or 174.2 per cent. The increase was on account of repayment of the US Dollar 600 million (Ksh 53 billion) syndicated loan.

Table 3-4: Kenya, Breakdown of External Debt Service Payments by Creditor Category, 2011 - 2015 in (Ksh million)

Creditor		June 2011	June 2012	June 2013	June 2014	June 2015 [a]	June 2015 (%)
Multilateral	Principal	10,062	12,560	12,210	11,550	13,349	11.8
	Interest	3,189	3,781	3,702	5,580	4,881	4.3
	Sub Total	13,251	16,341	15,912	17,130	18,230	16.1
Bilateral	Principal	10,958	11,394	11,783	13,419	13,097	11.5
	Interest	3,846	3,570	5,012	6,640	10,574	9.3
	Sub Total	14,804	14,964	16,795	20,059	23,671	20.8
Commercial	Principal	0	0	0	831	53,768	47.4
	Interest	0	0	2,337	3,380	17,875	15.7
	Sub Total	0	0	2,337	4,211	71,643	63.1
Grand Total	Principal	21,020	23,954	23,993	25,800	80,214	70.6
	Interest	7,035	7,351	11,051	15,600	33,330	29.4
	Total	28,055	31,305	35,044	41,400	113,544	100
Percentage Distribution							
Multilateral		47.2%	52.2%	45.4%	41.4%	16.1%	
Bilateral		52.8%	47.8%	47.9%	48.5%	20.8%	
Commercial		0.0%	0.0%	6.7%	10.2%	63.1%	
Total		100.0%	100.0%	100.0%	100.0%	100.0%	
[a] Provisional							

Source: National Treasury

3.5 Disbursements of External Loans

Total disbursements as at end June 2015, on external project loans and A-I-A recorded a growth of 125.6 per cent to Ksh 296,574 million from Ksh 131,452 million in June 2014 (Table 3-5).

Table 3-5: External Loans Disbursements in (Ksh million)

Type of disbursement	June 2011		June 2012		June 2013		June 2014		June 2015	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Project Cash Loans	28,390	47.6	19,343	27.3	23,569	27.3	28,432	21.6	3,454	1.2
Project A-I-A	31,288	52.4	51,393	72.7	62,622	72.7	68,420	52.0	218,159	73.6
Commercial Financing	0	0.0	0	0.0	0	0.0	34,600	26.3	74,961	25.3
Total	59,678	100	70,736	100	86,191	100	131,452	100	296,574	100

Source: National Treasury

CHAPTER FOUR: ON-LENT LOANS

4.1 Introduction

On-lending is an arrangement where the National Government through the National Treasury contracts loans from external or domestic sources or uses tax revenues and lends to public enterprises. This arrangement is guided by the following considerations:

i) The public enterprise is strategic and therefore requires funding by Government;
ii) The public enterprise has a weak balance sheet and cannot attract competitive funding from external or domestic sources; and
iii) A social welfare project that would be more efficiently executed by a public enterprise on behalf of the Government.

Substantial default by the borrowers of on-lent loans may severely constrain efficient debt management, which ultimately impact on debt sustainability. Such default, therefore, calls for establishment of better institutional processes as well as monitoring of contingent liabilities to promote efficient management of costs and risks in government debt portfolio.

4.2 Stock of On-Lent Loans

The outstanding on-lent loans **excluding** arrears and interest increased by Ksh 15,565.8 million from Ksh 181,287.3 million as at end June 2014 to Ksh 196,853.1 million as at end June 2015 (Table 4-1). This increase is attributed to new loans on-lent to the Water and Irrigation and Energy and Petroleum sectors. The Stock of On-Lent Loans to the Energy and Petroleum sector had reached Ksh 114,053.4 million as at end June 2015 up from Ksh 107,211.0 as at end June 2014.

Table 4-1: Stock of On-Lent Loans in (Ksh million)

Sector	June 2013	June 2014	June 2015
Education	11,088.9	11,088.9	11,088.9
Finance	1,667.1	2,110.2	1,088.4
Water and Irrigation	40,261.8	40,131.4	49,387.6
Tourism	182.0	181.0	181.0
Energy and Petroleum	92,235.2	107,211.0	114,053.4
Transport and Infrastructure	3,924.9	3,779.0	3,582.5
Planning and Devolution	8,757.0	8,757.0	8,757.0
Agriculture , Livestock and Fisheries	7,293.2	7,561.5	7,267.1
Trade and Industry	453.9	461.0	453.9
Cooperative	1,075.6	6.3	993.3
Total	166,939.6	181,287.3	196,853.1

Source: National Treasury

4.3 Status of On-Lent Loans including Arrears

As at end June 2015, the total on-lent loan portfolio amounted to Ksh 233,682.8 million, out of which outstanding loans, principal arrears and accrued interest stood at Ksh 196,853.1 million, Ksh 12,334.6 million and Ksh 24,495.1 million, respectively (Table 4-2).

Table 4-2: Status of On-Lent Loans Portfolio as at June 2015 in (Ksh million)

Ministry/Sector	Outstanding loans	Principal Arrears	Accrued interest	Total
Education	11,088.9	118.8	32.1	11,239.8
Finance	1,088.4	-	-	1,088.4
Water & Irrigation	49,387.6	2,321.5	4,423.5	56,132.6
Tourism	181.0	134.0	556.4	871.4
Energy & Petroleum	114,053.4	-	-	114,053.4
Transport and Infrastructure	3,582.5	96.7	44.6	3,723.8
Planning & Devolution	8,757.0	4,843.8	10,715.6	24,316.4
Agriculture , Livestock & Fisheries	7,267.1	4,417.2	8,548.4	20,232.7
Trade and Industry	453.9	0.1	1.2	455.2
Cooperative	993.3	402.5	173.3	1,569.1
Total	196,853.1	12,334.6	24,495.1	233,682.8

Source: The National Treasury

4.4 Receipts from On-Lent Loans

The total receipts by Government from on-lent loans amounted to Ksh 4,289.9 million during FY2014/15, out of which Ksh 2,685.9 million was principal and Ksh 1,604.0 million was interest (Table 4-3).

Table 4-3: Principal and Loan Interest Receipts from on-lent loans, 2014/15 in (Ksh million)

Organization	Principal Receipts	Interest Receipts	Total
Kenya Power & Lighting Co.	1,077.3	368.0	1,445.3
Kenya Generating Company	968.4	995.9	1,964.3
Agricultural Finance Corporation	20.0	-	20.0
K - Rep Bank Ltd	97.6	6.9	104.5
Nyeri Water and Sewerage	50.4	22.4	72.8
Kenya Airports Authority	173.5	113.5	287.0
Athi Water Services Board	80.0	39.7	119.7
Equity Bank Ltd	157.5	55.5	213.0
Co-operative Bank of Kenya	26.6	1.3	27.9
Agricultural Settlement Fund and Central Land Board	1.3	0.8	2.1
Uchumi Supermarkets Ltd	33.3	-	33.3
Total	2,685.9	1,604.0	4,289.9

Source: National Treasury

CHAPTER FIVE: FISCAL COMMITMENTS AND CONTINGENT LIABILITIES AND PUBLICLY GUARANTEED DEBT

5.1 Fiscal Commitments and Contingent Liabilities

5.1.1 Recognizing Potential Fiscal Risks

The effective implementation of the legal requirements under the public finance management has collectively resulted in better accountability structures and processes for managing, monitoring and reporting all explicit forms of fiscal obligations or commitments.

More recently, challenges have emerged from the international arena with regard to the financial management of contingent liabilities. These implicit financial obligations are not normally captured in financial debt statistics or accounting protocols. These have proven to be potent fiscal risks in other jurisdictions due to their off-balance sheet nature. Their occurrence can trigger a substantial funding call on government financial resources as they have tended to be outside the budget framework thus undermining fiscal prudence.

In recognition of this potential risk scenario and to adequately address the challenge, the National Treasury established the Fiscal Commitments & Contingent Liabilities (FCCL) Unit in June 2015, domiciled at the Directorate of Public Debt Management Office.

5.1.2 The Fiscal Commitments & Contingent Liabilities (FCCL) Unit

The FCCL Unit has the primary mandate and responsibility for ensuring that:

- a rigorous risk management framework and review protocol is applied as a key step in project approvals in line with the PPP Act 2013 and the PFM Act 2012;
- government fiscal risk exposure from PPP projects is adequately identified, quantified, provisioned for, mitigated against and managed;
- all such fiscal risks are equitably allocated between the public and private parties to a PPP project;
- all such fiscal risks, having been provisioned and/or mitigated against, are disclosed under government reporting conventions in line with international best practice;
- a risk awareness and management paradigm is inculcated into all project analyses as a measure of prudent, best practice financial management.

FCCL Management Framework

The FCCL Unit is guided by an FCCL management framework which lays out the process for achieving the above objectives. Since commencing operations in June 2015, the Unit has proceeded to institutionalize the framework through the application of various tools, templates and models to conduct FCCL assessments of projects. The Unit reports on the same, and the sustained engagement of other government entities to apply risk-based approaches to their project management practices.

To date, this institutionalization process has also resulted in the assessment of a portfolio of PPP projects that predate the advent of the PPP Act 2013, mainly in the energy and transport sectors. Preliminary estimates derived from the government's contingent liability exposure will be disclosed and reported with other government financial statistics. The FCCL review of current proposed PPP projects is ongoing as it forms a mandatory component of the PPP project approvals process under Section 35(2) of the PPP Act 2013.

5.1.3 Two types of fiscal risks

Fiscal Commitments

These are direct liabilities that are incurred by the government in support of implementing a project, a defined and quantified undertaking to pay or carry a funding obligation for a feature, phase or item in a project essential to its development, operation or completion. Its salient characteristic is that its quantum and timing are known and fixed. In the public private partnership context, this may take the form of an annuity or availability payment.

Contingent Liabilities

These are obligations that arise from a particular discrete but uncertain future event that is outside the control of the government. The occurrence of the trigger event, the value, and timing of a payment obligation may all be unknown or cannot be definitively determined. This uncertainty makes it challenging but not impossible to provide for.

Examples of contingent liabilities include government guarantees to third parties on particular project risk variables such as minimum prices and/or traffic volumes, some mitigation undertakings by government against types of risk third parties are unwilling to take such as adverse political events or credit guarantees, among others. Being aware of and managing these risks under a risk-based paradigm has been a key part of the Unit's function within the PDMO.

5.1.4 Wider role in risk-based paradigm

The PDMO through the FCCL unit continues to play a strong facilitative role in strengthening risk management processes within and in other government entities by: testing risk management due diligence among government entities seeking project approvals; facilitating the development of a policy framework to govern the issuance of government letters of comfort and in training PDMO staff.

5.2 Publicly Guaranteed Debt

Publicly guaranteed debt, refers to the debt owed by public entities to both foreign and local creditors but guaranteed by national government. The debts may be denominated in domestic or foreign currency.

5.2.1 Stock of Publicly Guaranteed Debt

Table 5-1 shows that outstanding Government guaranteed debt decreased by Ksh 1,288 million to Ksh 43,933 million as at end June 2015 from Ksh 45,221 million as at end June 2014.

Table 5-1: Outstanding Stock of Publicly Guaranteed Debt, 2014/2015 in (Ksh Million)

Agency	Year Loan Contracted	Purpose of Loan	Creditor	Stock			
				Jun-12	Jun-13	Jun-14	Jun-15
Nairobi City County	1985	Umoja II Housing Project	USA	214.8	146.2	74.5	-
Kenya Broadcasting Corporation	1989	KBC Modernization Project	Japan	5,996.6	3,933.9	3,584.2	2,403.6
Telkom Kenya Ltd	1990	Purchase of Microwave Telephone System	Canada	362.2	352.6	350.5	374.8
Tana and Athi River Development Authority	1990	Tana Delta Irrigation Project	Japan	2,495.5	1,790.6	1,525.5	1,172.2
East African Portland Cement	1990	Cement Plant Rehabilitation Project	Japan	3,102.2	2,225.9	1,896.3	1,457.1
KenGen Ltd	1995	Mombasa Diesel Generating Power Project	Japan	5,868.9	4,442.4	4,047.6	3,392.9
	1997	Sondu Miriu Hydropower Project	Japan	5,564.1	4,268.4	3,949.9	3,372.3
	2004	Sondu Miriu Hydropower Project II	Japan	11,202.6	9,186.4	8,981.0	8,005.1
	2007	Sondu Miriu Hydropower Project – Sang'oro Power Plant	Japan	4,184.9	3,670.7	3,660.0	3,416.0
	2010	Olkaria Unit 4 and 5 Geothermal Power Project	Japan	51.2	42.0	41.7	44.3
Kenya Ports Authority	2007	Mombasa Port Modernization Project	Japan	4,549.9	9,607.8	13,166.8	15,855.8
Kenya Railways	2008	Kenya Railways Concessioning	IDA	3,790.5	3,870.3	3,943.2	4,438.8
Kenya Farmers Association	2005	Revival of KFA	Local banks	Unutilized	Unutilized	Unutilized	Unutilized
National Cereals & Produce Board (GSM-102)	2009	Importation of maize under GSM-102	USA	Unutilized	Unutilized	Unutilized	Unutilized
Total				47,383.4	43,537.2	45,221.2	43,932.9

Source: The National Treasury

5.2.2 Payments by the Government on Publicly Guaranteed Debt

During the FY2014/15 period, the Government as a guarantor spent Ksh 1,014.9 million to service guaranteed debts owed by public enterprises in financial distress and where guarantees have been called. As shown in Table 5-2, these public enterprises included City County of Nairobi, Tana and Athi River Development Authority and Kenya Broadcasting Corporation with the latter accounting for about two-thirds (65.4 per cent) of the payments made in 2014/15.

Table 5-2: Payments by the Government on Guaranteed Debt: 2010/11- 2014/15, (Ksh million)

Year	Borrower	Quarter I	Quarter II	Quarter III	Quarter IV	Cumulative Total
2010/11	CCN	-	37.2	37.7	-	74.9
	TARDA	-	176.2	193.6	-	369.8
	KBC	-	450.3	-	514.2	964.5
	Total	-	663.7	231.3	514.2	1,409.2
2011/12	CCN	42.5	-	-	-	42.5
	TARDA	229.4	-	-	185.3	414.7
	KBC	-	-	504.2	-	504.2
	Total	271.9	-	504.2	185.3	961.4
2012/13	CCN	37.8	-	38.5	-	76.3
	TARDA	193.4	-	158.7	-	352.1
	KBC	-	461.8	-	400.4	862.2
	Total	231.2	461.8	197.2	400.4	1,290.6
2013/14	CCN	-	37.7	38.1	-	75.8
	TARDA	154.8	-	147.5	-	302.3
	KBC	-	360.7	-	373.8	734.5
	Total	154.8	398.4	185.6	373.8	1,112.6
2014/15	CCN	38.8	-	40.0	-	78.7
	TARDA	142.4	-	130.1	-	272.6
	KBC	-	324.7	-	338.9	663.6
	Total	181.2	324.7	170.1	338.9	1,014.9
Total owed for the period 2010/11 to 2014/15	CCN	119.10	74.90	154.30	-	348.2
	TARDA	720.00	176.20	629.90	185.30	1,711.5
	KBC	-	1,597.50	504.20	1,627.30	3,729.0
	Total[7]	839.10	1,848.60	1,288.40	1,812.60	6,233.4

Source: The National Treasury

[7] This is not the entire amount owed. There are other obligations owed from earlier years

CHAPTER SIX: DISPUTED EXTERNAL COMMERCIAL DEBT

6.1 Background

Kenya's disputed external commercial debt is estimated at Ksh 16,628 million or 1.2 per cent of total public debt at end June 2015. In August 2004, the Government suspended payments pending verification of the amount due on each of the eighteen (18) suppliers' credit contracts which constitutes external commercial debt. Soon after the suspension, the Controller and Auditor General undertook a special audit on eighteen (18) suppliers' credit contracts as follows:

1. Eleven (11) contracts that are in dispute;
2. Three (3) contracts though fully paid by the Government, relate to projects in dispute as under (1) above; and
3. Four (4) contracts in which the creditors voluntarily returned all funds paid by the Government.

In four (4) of the eleven (11) suppliers' credit contracts in dispute, the creditors sought legal redress in courts or arbitrations in UK, The Hague and Switzerland for breach of contract. In response, the Government engaged reputable and experienced international law firms to represent its interest.

In February 2005, the Ethics and Anti-Corruption Commission (EACC) began investigations on these contracts. Although some progress has been made, the pace has been slowed down by court orders that have prohibited EACC from carrying out investigations in some areas.

6.2 Audits on External Commercial Debts

The Controller and Auditor General's Special Audit Report was tabled in Parliament in May 2006. The findings indicated that procurement laws and regulations were violated in the contracting process, that the projects were overpriced and in most cases, no credit was extended by the creditors. The Report recommended that professional valuation of works, goods and services be carried out to determine value for money.

In January 2007, the National Treasury contracted PricewaterhouseCoopers (PwC) to conduct forensic audit and valuation. PwC submitted the forensic audit and valuation report on 31st July, 2007. The PwC Report established that those contracts were procured in an irregular manner and that the pricing, financing, and other terms of the contract do not reflect terms obtained on arm's length commercial transactions.

Specifically, the PwC Report cited:

i) Significant overpricing
ii) Serious contraventions of Kenya public expenditure law
iii) Circumstantial evidence that these contracts were corruptly procured
iv) Evidence of pre-financing (i.e. upfront payments) by the Government but paying interest on own funds.

v) Under-delivery of supplies provided under the contracts

As a precautionary measure, the Government sought to eliminate financial risk exposure on Promissory Notes issued under seven (7) contracts. The Minister for Finance, in consultation with the Attorney General, issued a Caveat Emptor in December 2007 informing all parties that the underlying contracts were fraudulent and hence the Promissory Notes were illegal and the Government would not honor them. The Caveat Emptor was circulated to banks worldwide through SWIFT and placed in the local dailies.

6.3 Government Position on Existing Commercial Debts

The Government is committed to resolving the dispute on the outstanding external commercial debts on the basis of fair value received by the Government on each contract as determined by independent valuers and based on legal advice. On the other hand, the Government will take legal measures to recover from the suppliers any payments over and above the fair value received. Four of the 11 contracts in dispute have been successfully resolved. Resolution of the remaining projects is ongoing. To achieve this, there will be enhanced co-ordination by state organs including; State Law Office, Ethics and Anti-Corruption Commission, Directorate of Public Prosecutions and the National Treasury.

6.4 Lessons Learnt from External Commercial Debt

Some key lessons have been learnt on this matter referred to by the media as the “Anglo Leasing” scandal. First, weak institutional arrangement of public debt management undermined accountability and transparency in the contracting, disbursement and payment processing of external loans. To address this weakness, the Government has embarked on a comprehensive public debt management reform program to set up a fully functional Public Debt Management Office (PDMO) at the National Treasury responsible for all matters relating to public debt.

Second, inadequate public financial management system weakens budget formulation and implementation. This partly explains payment of suppliers’ credit contracts against under-deliveries. Public Financial Management Reforms have been undertaken to strengthen the budget, accounting and control systems in National Government.

Third, weak legal framework on public procurement permitted single sourcing on account of national security concerns. Whereas restricted tendering system or single sourcing is not wrong per se, it can be subject to abuse in absence of robust framework of checks and balances. This matter has to a large extent been addressed in the Public Procurement and Disposal Act.

Finally, lack of formal debt policy and strategy that guides debt management operations created fiscal risk through high cost borrowing to finance non-priority expenditures. As a remedial measure, the National Government prepares an annual Medium Term Debt Strategy (MTDS) that indicates the preferred borrowing sources and levels to finance the budget deficit taking into account debt sustainability in terms of cost and risk. Specifically, external commercial borrowing will be contracted transparently from reputable financial institutions or through issuance of International Sovereign Bond as was done in June and December 2014.

CHAPTER SEVEN: DEBT STRATEGY AND DEBT SUSTAINABILITY

7.1 Debt Strategy

The National Treasury, in the last seven years, since 2009 has been preparing the Medium Term Debt Management Strategy (MTDS) which outlines the government borrowing policy by evaluating the cost and risk characteristics of both the existing public debt portfolio and alternative borrowing mix since 2009. Further, the strategy incorporates initiatives to develop a vibrant domestic debt market. A summary of the 2014 MTDS is presented in Box 1.

Table 7-1: Alternative Debt Management Strategies

Box 1: 2014 MEDIUM TERM DEBT MANAGEMENT STRATEGY (MTDS)

I. ALTERNATIVE BORROWING STRATEGIES

The 2014 MTDS evaluated the following five (5) possible debt financing strategies (See Table 7-1):

1. Strategy 1 (S1. 2013 MTDS) was the preferred strategy in 2013 and assumed 40% external mainly from concessional borrowing and 60% domestic financing. The concentration of issuance with 2 and 5 year maturities assumes an initiative to reduce cost of domestic debt associated with longer dated securities.
2. Strategy 2 (S2. Concessional external borrowing) assumes 40% external financing and 60% domestic financing. More concessional debt to reduce cost.
3. Strategy 3 (S3. More domestic debt) assumes 35% external and 65% domestic financing.
4. Strategy 4 (S4. Medium term domestic borrowing) assumes 30% external and 70% domestic financing. External borrowing from concessional and semi concessional creditors.
5. Strategy 5 (S5. Semi-concessional external financing). Under this strategy, domestic debt is 75% while external debt is 25%.

Table 7-1: Alternative Debt Management Strategies, Kenya

Envisaged New debt	*2013 MTDS* *S1*	Concessional external debt S2	More domestic debt S3	Medium term domestic debt S4	Semi-concessional external debt S5
Domestic	60%	60%	65%	70%	75%
1-year	9%	9%	10%	10%	14%
2-year	11%	10%	12%	11%	11%
5-year	12%	14%	13%	20%	14%
10-year	10%	11%	11%	16%	14%
15-year	9%	8%	10%	7%	11%
20-year	9%	7%	10%	7%	11%
External	40%	40%	35%	30%	25%
Concessional	17%	26%	23%	20%	15%
Semi-concessional	3%	8%	6%	4%	4%
Commercial	20%	6%	6%	6%	6%

II. 2014 MTDS

After analyzing the strategies, S2 was identified as the optimal strategy which entails:

- 60% net domestic financing and 40% external financing;
- The domestic borrowing will be on medium term basis;
- External borrowing will comprise of 26% on concessional terms, 8% on semi concessional terms while 6% will be contracted on commercial terms.

Source: 2014 MTDS, National Treasury

7.2 Implementing the 2014 MTDS

The Government implemented the 2014 MTDS through the domestic borrowing plan by issuing Treasury Bills and Treasury Bonds of medium term maturity. The external borrowing plan was effected through contracting concessional loans and issuance of an International Sovereign Bond.

7.3 Debt Sustainability

Debt sustainability of a borrower is the ability to service its debts as they fall due without restructuring, defaulting or compromising its long-term goals and objectives. Maintaining the sustainability of external debt is vital for a country, as it has limited options to settle financial obligations in foreign currencies.

Debt Sustainability Analysis (DSA) conducted in 2015 concludes that Kenya's debt is sustainable. The DSA compares debt burden indicators to indicative thresholds over a 20-year projection period. A debt-burden indicator that exceeds its indicative threshold suggests a risk of experiencing some form of debt distress. There are four ratings for the risk of external debt distress:

i) Low risk - when all the debt burden indicators are well below the thresholds;
ii) Moderate risk - when debt burden indicators are below the thresholds in the baseline scenario, but stress tests indicate that thresholds could be breached if there are external shocks or abrupt changes in macroeconomic policies;
iii) High risk - when the baseline scenario and stress tests indicate a protracted breach of debt or debt-service thresholds, but the country does not currently face any repayment difficulties; or
iv) In debt distress - when the country is already having repayment difficulties.

Countries are classified into one of three policy performance categories (strong, medium, and poor) using the World Bank's Country Policy and Institutional Assessment (CPIA) index, which uses different indicative thresholds for debt burdens depending on the quality of a country's policies and institutions (Table 7-2). Kenya is rated a strong policy country and as such is subject to the following thresholds.

Table 7-2: External debt sustainability thresholds

Classification	NPV of Debt in per cent of:			Debt Service in per cent of:	
	GDP	Exports	Revenue	Exports	Revenue
Strong Policy Performer	50	200	300	25	22

Source: IMF County Report N0. 15/269, September 2015

7.3.1 External debt sustainability

As shown in Table 7-3, Kenya's debt ratios suggest that external debt is within sustainable levels for a country rated as a strong performer. This may be attributed to the high level of concessionality of current external debt and the positive outlook in other macroeconomic indicators.

Table 7-3: Kenya's External debt sustainability

Indicator	2014	2015	2016	2017	2019	2024
PV of debt–to-GDP ratio (50)	19.6	22.1	22.1	21.8	21.2	18.2
PV of debt-to-exports ratio (200)	107.7	120.4	123.4	123.2	122.3	110.3
PV of debt-to-revenue ratio (300)	102.2	110.9	103.6	99.1	94.8	81.3
Debt service-to-exports ratio (25)	27.8	29.9	31.9	32.9	39.0	41.4
PPG-Debt Service –to exports ratio	9.0	6.8	8.0	8.7	14.0	17.1
Debt service-to-revenue ratio (22)	8.6	6.0	6.7	7.0	10.9	12.6

Source: IMF County Report N0. 15/269, September 2015

7.3.2 Public Debt Sustainability

Table 7.4 shows that the PV of public debt-to-GDP was at 45.8 per cent in 2014 but is expected to gradually decline to 43.1 per cent by 2020. In the long term, the ratio is expected to decline to 37.3 per cent in 2024.

Given Kenya's relative strong revenue performance, the PV of public debt-to-revenue is expected to remain at sustainable levels. The debt service-to-revenue ratio remains consistent. Overall, the results from the DSA indicate that Kenya's public debt remains sustainable over the medium term.

Table 7-4: Kenya's Public debt sustainability

Indicator (Threshold)	2014	2015	2016	2017	2018	2019	2020	2024
PV of public sector debt to GDP ratio (74)	45.8	48.5	48.1	47.3	46.0	44.4	43.1	37.3
PV of public sector debt-to-revenue ratio (300)	238.7	243.3	225.9	214.8	205.8	199.2	196.7	166.6
Debt service-to-revenue ratio (30)	34.0	29.7	28.1	26.6	25.2	27.9	24.1	26.4

Source: IMF County Report N0. 15/269, September 2015

In Table 7-5, a worst-case scenario, a "borrowing shock" scenario is presented which assumes a Government borrowing of 10 per cent of GDP in FY2014/15.

Table 7-5: Kenya's Sensitivity Analysis for Key Indicators of Public Debt

Indicator	Threshold	2015 ratios	Impact of 10% of GDP increase in borrowing in 2015 on debt indicators in 2017
PV of Debt as % of GDP	74	49	54
PV of Debt as % of Revenue	300	243	237
Debt Service as % of Revenue	30	29	29

Source: IMF County Report N0. 15/269, September 2015

The results indicate that even under this extreme shock, Kenya's public debt remains sustainable.

CHAPTER EIGHT: INTERNATIONAL SOVEREIGN BOND

8.1 Background

The Republic of Kenya reopened the debut USD 2,000 million International Bond in November, 2014. The reopened issue comprised USD 250 million at a coupon rate of 5.875 per cent and a yield of 5.000 per cent with a five year maturity and USD 500 million at a coupon rate of 6.875 per cent and a yield of 5.900 per cent with a maturity of 10 years. The two tranches of the bond are identical in all material features to the inaugural bond.

The issue received about 394 per cent subscription with total demand amounting to USD 3,000 million. The bond is listed on the Irish Stock Exchange (ISE).

8.2 Strategic objectives of the International Sovereign Bond

The National Treasury chose a tap on the back of inaugural bond as it enabled issuance of additional debt at much lower transaction costs than a new issue. This is due to the following reasons:

Simplicity: The documentation used, including the Prospectus was the original issuance documentation which was updated to take into account new information since the issuance of the debut bond in June 2014 including the rebased GDP numbers.

Speed: As regards marketing, there was no need for a physical roadshow since the National Treasury could leverage on the road show undertaken for the debut bond. The Lead Banks were in constant touch with the investors who were expected to invest in the issue hence making the tap quicker and more efficient.

Pricing: Pricing of the tap was simple compared to the initial issuance as the bond was already trading. In this regard, the pricing was in favour of Republic of Kenya given that the bond was trading at a premium in the secondary market with the yields at 5.0 per cent and 5.9 per cent for the five - year and the ten -year bonds respectively. The Government received a bonus of US$44 million due to this favourable pricing.

Marketing Strategy: The marketing strategy by National Treasury in the deal was to limit the time in the market to one day. The investor presentation (slide version) and the e-Prospectus were posted on *netroadshow* (an on-line marketing portal for Qualified Institutional Buyers - QIBs) on the same day after the announcement of the deal. This had the effect of reducing the cost of marketing by eliminating expensive physical roadshows abroad.

8.3 Key terms of the issue

The following is a summary of the key terms of the issue.

Nominal Value	USD 750 million	
Issuer	Kenya	
Ratings	S&P / Fitch B+ (stable)	
Issue format	144A / Reg S	
Settlement date	November, 2014	
Governing law	English	
Listing	Irish Stock Exchange	
Issue Size	USD 250 million	USD 500 million
Maturity date	June 24, 2019	June 24, 2024
Coupon (%)	5.875	6.875

Source: National Treasury

8.4 Use of proceeds

The proceeds were used for general budgetary purposes, including funding of infrastructure projects, energy and agriculture.

8.5 Outcome of USD 500 Million Note Auction at the Primary Market

Fifty (50) per cent of the notes were held by UK investors followed by US and other European investors at 37 per cent and 13 per cent respectively (Figure 8-1). In terms of the holdings by investor type, fund managers led the pack at 83 per cent while banks and insurance and pension funds followed at 2 per cent each (Figure 8-2), the Hedge Funds held 13 per cent.

Figure 8-1: Distribution of Investors by Geography

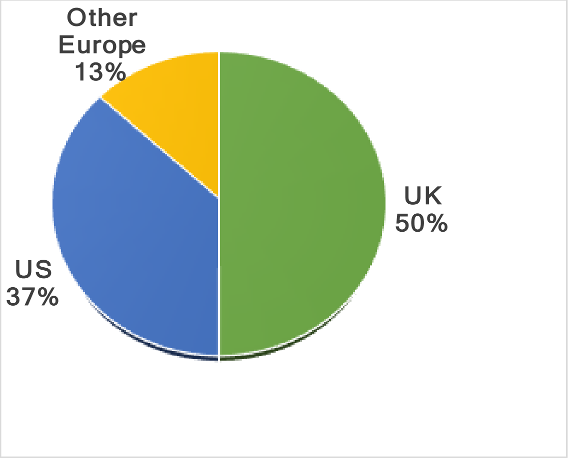
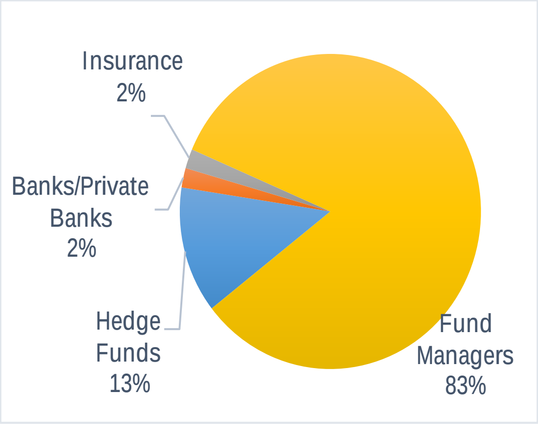


Figure 8-2: Distribution of Investor by Type



Source: National Treasury

8.6 Outcome of Primary Market Auction of USD 250 Million Note

Figure 8-3 shows that the Note was held by US investors at 33 per cent, UK investors at 33 per cent and Other Europe at 34 per cent. In terms of distribution by investor type, fund managers held 70 per cent, banks and insurance companies 6 per cent and Hedge funds at 24 per cent (Figure 8-4).

Figure 8-3: Distribution of Investors by Geography

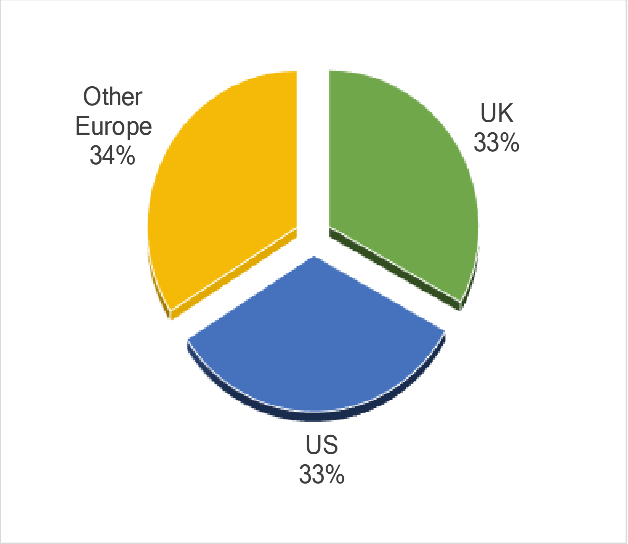
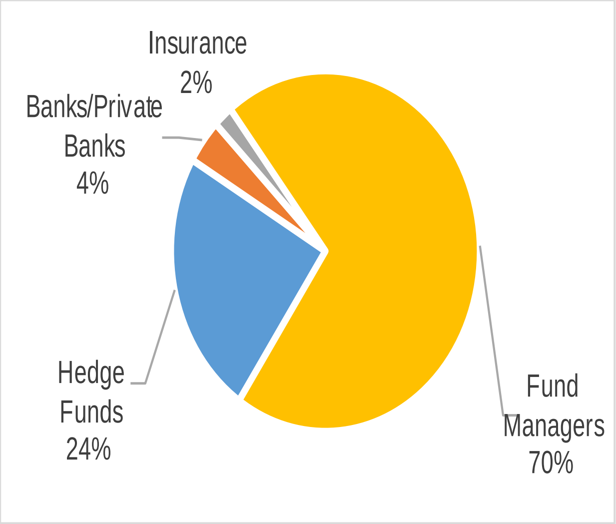


Figure 8-4: Distribution by Investor Type



Source: National Treasury

8.7 Success of the Sovereign Bond

The impressive performance of the ISB issuance was driven by the country's strong credit status and extensive marketing to global investors. Key selling points for Kenya were as follows.

i) **Sound macroeconomic management**: Investors had confidence in the Government's ability to maintain and consolidate macro-economic stability, improve business climate and implement free-market oriented reforms.

ii) **Stable credit rating**: The two reputable credit rating agencies — S&P and Fitch — have maintained their ratings for Kenya at B+ with stable outlook. Kenya's current account and budget deficits are financeable and do not undermine macroeconomic stability and sustainable public debt.

iii) **Diversified economy with strong private sector**: No one sector of Kenya's economy contributes more than 25 per cent of GDP. Indeed, growth realized over the recent past remains broad-based. The economy is expected to be more diversified with new sectors such as oil and gas as well as mining becoming increasingly important.

iv) **Modern Constitution with checks and balances that has strengthened institutions**: Ongoing and successful implementation of reforms under the new Constitutional dispensation is expected to improve governance leading to a well-managed devolution system to improve service delivery and achieve equitable social progress.

v) **Well-developed banking system and domestic capital market**: Kenya has the largest banking system in Eastern Africa region and the third largest in Africa after South Africa and Nigeria. The financial sector is well capitalized.

vi) **Low external debt levels vis-à-vis peers**: Kenya has maintained its public debt at a sustainable level even without receiving debt relief or write-off under the HIPC and MDRI initiatives. The external debt remains low and manageable.

vii) **Important economic, commercial and logistical hub:** Kenya is the gateway to Eastern Africa and an important host of large international corporations and boasts of relatively advanced physical infrastructure.

viii) **Progressive reform agenda with focus on infrastructure investment:** Kenya is addressing the root causes of weak competitiveness with its investment in energy, transport, and agriculture sectors. It is also addressing security concerns and investing in human capital development including health, education and social protection.

CHAPTER NINE: LEGAL FRAMEWORK ON PUBLIC DEBT MANAGEMENT

9.1 Provisions under the Constitution

9.1.1 Public debt as defined under the Constitution

Public debt is all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the national government. Public debt is a charge on the Consolidated Fund, but an Act of Parliament may provide for charging all or part of the public debt to other public funds. The relevant legislation with regard to public finance management in Kenya is the Public Finance Management Act of 2012.

9.1.2 Borrowing by the National Government

Parliament may prescribe the terms on which the national government may borrow and impose reporting requirements. Parliament may request the Cabinet Secretary responsible for Finance to present information concerning any particular loan or guarantee. The information may consist of:

- Extent of the total indebtedness by way of principal and accumulated interest;
- The use of the proceeds of the loan; and
- Provision made for servicing or repayment of the loan.

9.1.3 Borrowing by Counties

The two important conditions for a county government to qualify for own borrowing are; possession of national government guarantee and approval of the borrowing by the county government's assembly (Article 212).

9.1.4 Loan guarantees by national government

Parliament shall prescribe terms and conditions under which the national government may guarantee loans and a report on guarantees issued within a financial year will be published within two months after the end of the year.

9.2 Public Finance Management Act

The PFM Act has consolidated all pre-existing laws on Public Financial Management. In the area of public debt management, the Act repealed the External Loans and Credit Act, the Internal Loans Act and the National Government Loans Guarantee Act which provided a legal framework for Government to raise loans outside Kenya, within Kenya and to guarantee loans extended to public entities, respectively.

The Act provides for a number of reforms with respect to management and control of public finance including public borrowing as follows:

a) *Article 11:* Establishment of the National Treasury (NT) headed by the Cabinet Secretary to be responsible for fiscal policy and managing public finances.
b) *Articles 25 and 33:* NT to prepare and submit to Cabinet the Budget Policy Statement (BPS) and Debt Management Strategy by 15th February each year. Thereafter, Parliament shall discuss the BPS and MTDS within 2 weeks and NT will publish the same within 15 days.

c) *Articles 28-29:* NT to establish a Treasury Single Account (TSA) and associated cash management framework.
d) *Articles 47-65:* Prescribe for the receipt and the use of grants and loans, guaranteeing loans, lending money, entering into derivative transactions and the establishing of a fully-fledged Public Debt Management Office (*PDMO*) in the NT.

Articles 47 and 48 provides for the conditions for receiving grants and donations by National Government or its entities or third parties as well as regulations on the administration of the same.

Article 49: Authority for borrowing by the National Government

The Cabinet Secretary for Finance may, on behalf of the national government, raise a loan within Kenya or from outside Kenya only if the loan and the terms and conditions for the loan are set out in writing and in accordance with:

- The fiscal responsibility principles and the financial objectives set out in the most recent Budget Policy Statement
- Debt management strategy of the national government over the medium term

Article 50 provides for the obligations and restrictions on national government guaranteeing and borrowing. The national government may borrow money in accordance with PFM Act or any other legislation and shall not exceed a limit set by Parliament. The national government may borrow money only for the budget as approved by Parliament and the allocations for loans approved by Parliament. The guarantee of debt shall be done in terms of criteria agreed with the Intergovernmental Budget and Economic Council (IBEC) and prescribed in regulations approved by Parliament. In addition, the Cabinet Secretary may, by regulations approved by Parliament, establish a sinking fund or funds for the redemption of loans raised under this Act by the national government.

Article 51 contains provisions for borrowing by national government entities where a national government entity may borrow in accordance with PFM Act or any other Act of Parliament. A national government entity shall obtain the approval of the Cabinet Secretary for its intended program of borrowing, refinancing and repayment of loans over the medium term; and for the forthcoming financial year, prior to the beginning of that financial year.

Under *Article 52*, persons authorized to execute loan documents at national government are the Cabinet Secretary or any person designated by the Cabinet Secretary, accounting officer responsible for a national government entity, or any other specified officer authorized by legislation to execute loan documents on behalf of the entity.

Article 53 provides for issuance of securities by national government where the national government may issue national government securities, whether for money that it has borrowed or for any other purpose, only in circumstances expressly authorized by the PFM Act.

Article 54 provides that no duty is chargeable under the Stamp Duty Act for the issue of a national government security.

Article 55 establishes the office of the Registrar of the National Government Securities which shall be an office under the Public Debt Management Office. Securities issued by or on behalf of the national government shall be published and publicized.

Under *Article 56*, the national government may enter into derivative transactions, either directly or indirectly through an intermediary, but only within the framework and limits of the Budget Policy Statement and in a manner prescribed by regulations.

Article 57 allows the national government to lend money but only in accordance with terms and conditions prescribed by the regulations approved by Parliament.

Under *Article 58*, the Cabinet Secretary may guarantee a loan of a county government or any other borrower on behalf of the national government and that loan shall be approved by Parliament.

According to *Article 59*, the Cabinet Secretary shall submit a statement on loan guarantees to Parliament within fourteen days after the guarantee is entered into.

Article 60 relates to money payable in respect of a guarantee to be a charge on the Consolidated Fund. Money payable on a guarantee shall be paid only if the payment has been authorized by the Controller of Budget. On this account, money payable on a guarantee is a charge on, and is payable out of, the Consolidated Fund without further appropriation than this section.

Article 61 provides for recovery of amounts paid on a guarantee where money paid by the Cabinet Secretary on a guarantee, including any expenses incurred by the Cabinet Secretary in respect of the guarantee, shall be a debt due to the national government from the borrower whose loan was guaranteed; and be recoverable from the borrower as a debt due to the national government by proceedings brought in a court of competent jurisdiction or withholding a transfer of money in terms of Article 225 of the Constitution, if the borrower receives appropriations.

Article 62 provides for the establishment and objectives of the Public Debt Management Office (PDMO) within the National Treasury with objectives to: minimize the cost of public debt management and borrowing over the long-term taking account of risk, promote the development of the market institutions for Government debt securities and ensure the sharing of the benefits and costs of public debt between the current and future generations.

The functions of the Public Debt Management Office are provided under *Article 63* and they include:

i) carrying out the government's debt management policy of minimizing its financing cost over the long-term taking account of risk;

ii) maintaining a reliable debt data base for all loans taken by the national government, county governments and their entities including other loans guaranteed by the national government;

iii) prepare and update the annual medium-term debt management strategy including debt sustainability analysis;

iv) prepare and implement the national government borrowing plan including servicing of outstanding debts;

v) acting as the principal in the issuance of Government debt securities on behalf of the National Treasury;

vi) monitor and evaluate all borrowing and debt-related transactions to ensure that they are within the guidelines and risk parameters of the debt management strategy;

vii) process the issuance of loan guarantees including assessment and management of risks in national government guarantees;

viii) Transact in derivative financial instruments in accordance with best international practices benchmarked to the debt management offices of other governments that are internationally respected for their practices.

The Cabinet Secretary under *Article 64* shall develop the policy and financial framework in accordance with Constitutional principles within which the Public Debt Management Office operates.

Article 65 stipulates the relationship between the PDMO with county treasuries in debt management where the PDMO shall assist the county government in its debt management and borrowing at the request of a County Treasury.

9.3 Reporting under PFM Act

Article 31 requires that the Cabinet Secretary submits to Parliament, every four months, a report of all loans made to the national government, national government entities and county governments, in accordance with Article 211(2) of the Constitution.

Article 32 requires the Cabinet Secretary to submit to Parliament, a record of all guarantees given by the national government, not later than seven days after receiving a request to do so from either House of Parliament.

Article 33 requires that on or before the 15th February in each year, the Cabinet Secretary shall submit to Parliament a statement setting out the debt management strategy of the national government over the medium term with respect to its actual liability and potential liability in respect of loans and guarantees and its plans for dealing with those liabilities.

CHAPTER TEN: OUTLOOK FOR THE MEDIUM TERM

10.1Public Debt Stock in the Medium Term

The total public debt is projected to rise in nominal terms to Ksh 3,238,700 million in June 2016 from Ksh 2,843,696 million in June 2015 and further increase to Ksh 4,451,400 million in June 2019 (Table 10-1). However, as a proportion of GDP, public debt in nominal terms is projected to increase to 50.3 per cent in June 2016 from 49.9 per cent in June 2015 but decline to 48.7 per cent in June 2019.

The external debt is projected to account for 26.3 per cent of GDP in June 2016 from 25.0 per cent in June 2015 but decreases to 25.7 per cent in June 2019. The domestic debt decreases from 24.9 per cent as a proportion of GDP in June 2015 to 24.0 per cent in June 2016 and decreases further to 23.0 per cent in June 2019.

Table 10-1: Projected Public Debt Stock in (Ksh million)

	2014/15	2015/16	2016/17	2017/18	2018/19
External Debt	1,423,252	1,691,600	1,788,900	2,066,900	2,314,343
% of GDP	25.0%	26.3%	24.6%	25.4%	25.3%
Domestic Debt	1,420,444	1,547,100	1,693,800	1,927,200	2,076,505
% of GDP	24.9%	24.0%	23.3%	23.6%	22.7%
Total Public Debt	2,843,696	3,238,700	3,482,700	3,994,100	4,390,848
% of GDP	49.9%	50.3%	48.0%	49.0%	48.0%
Memoranda Items					
Nominal GDP	5,703,321	6,443,000	7,260,400	8,153,100	9,147,600
Ordinary Revenue	1,031,248	1,202,000	1,380,200	1,575,900	1,797,700

Source: National Treasury

10.2 Debt Service in the Medium Term

In nominal terms, the total debt service is projected to decrease from 24.3 per cent of revenue in 2014/15 to 22.6 per cent in 2017/18, and further decline to 20.3 per cent of revenue in 2018/19 (Table 10-2).

As a percentage of GDP, total debt service is projected to decrease from 4.4 per cent in 2014/15 to 3.6 per cent in 2015/16 but increase to 4.0 per cent in 2018/19.

Domestic interest is projected to increase from Ksh 139,6 billion in 2014/15 to Ksh 159.4 billion in 2015/16 and further to Ksh 178.6 billion in 2018/19. However, as a percentage of revenue, domestic interest is projected to decrease from 13.5 per cent in 2014/15 to 13.3 per cent in 2015/16 and further decrease to 9.8 per cent in 2018/19.

As a ratio of GDP, domestic interest will remain at 2.4 per cent in 2015/16 and thereafter decline to 2.0 per cent in 2018/19. On the other hand, interest on external debt is projected to increase from Ksh 32.3 billion in 2014/15 to Ksh 33.7 billion in 2015/16 and increase to Ksh 55.8 billion in 2018/19. As a ratio of GDP, interest on external debt will rise marginally from 0.6 per cent in 2014/15 to 0.8 per cent in 2016/17 and thereafter decrease to 0.6 per cent in 2018/19.

Annual principal repayments on external debt is projected to decline from Ksh 79.1 billion in 2014/15 to Ksh 38.4 billion in 2015/16, but increase thereafter to Ksh 135.9 billion in 2018/19. The spikes in 2017/18 and 2018/19 is on account of maturing US Dollars 750 million syndicated loan and sovereign bond respectively. As a ratio of GDP, the external repayments will increase marginally from 1.4 per cent in 2014/15 to 1.5 per cent in 2018/19.

Table 10-2: National Government Projected Debt Service in (Ksh million)

Debt Service		2014/15	2015/16	2016/17	2017/18	2018/19
Domestic interest	Amount (Ksh billion)	139.6	159.4	161.8	170.1	178.6
	% of GDP	2.4	2.5	2.2	2.1	2.0
	% of Revenue	13.5	13.3	11.6	10.7	9.8
External Interest	Amount (Ksh billion)	32.3	33.7	57.5	58.0	55.8
	% of GDP	0.6	0.5	0.8	0.7	0.6
	% of Revenue	3.1	2.8	4.1	3.6	3.1
Total Interest payments	Amount (Ksh billion)	171.9	193.1	219.3	228.1	234.4
	% of GDP	3.0	3.0	3.0	2.8	2.6
	% of Revenue	16.7	16.1	15.7	14.3	12.9
External Principal Repayments	Amount (Ksh billion)	79.1	38.4	47.1	132.2	135.9
	% of GDP	1.4	0.6	0.6	1.6	1.5
	% of Revenue	7.7	3.2	3.4	8.3	7.5
Total Debt service	Amount (Ksh billion)	251.0	231.5	266.4	360.3	370.3
	% of Revenue	24.3	19.3	19.1	22.6	20.3
	% of GDP	4.4	3.6	3.7	4.4	4.0
Memo items						
Ordinary Revenue	Amount (Ksh billion)	1,031.2	1,202.0	1,380.2	1,575.9	1,797.7
Nominal GDP	Amount (Ksh billion)	5,703.3	6,444.0	7,2259.4	8,149.0	9,149.0

Source: National Treasury, 2016 Budget Policy Statement

GLOSSARY

- Bond Conversion

This is a strategy where the outstanding volume of the bond is redeemed or converted into another or a new one with longer maturity provided the holders of such a portion are agreeable.

- Bond Reopening

This involves opening up or offering the same paper to the primary market on a date other than its original issue date with a view to increasing its outstanding size.

- Bond Switching

This a strategy in which a portion of an existing bond is exchanged through an auction process into another existing bond preferably of longer maturity or a new one to build the volume of the benchmark issue.

- Buy back

This is the sale of securities, usually Treasury Bonds, with an agreement from the seller to buy back the security within its life.

- Concessionality

A measure of the softness of a credit reflecting the benefit to the borrower compared to a loan at market rate. Technically, it is calculated as the difference between the nominal value and the present value of the debt service as of the date of disbursement, calculated at a discount rate applicable to the currency of the transaction and expressed as a per centage of the nominal value.

- Debt Relief

Agreements by creditors to lessen the debt burden of debtor countries by either rescheduling interest and principal payments falling due over a specified time period, sometimes on concessional basis, or by partially or fully cancelling debt service payments falling due in a specified period of time.

- Debt Rescheduling

A form of debt reorganization in which payments of principal and/or interest previously due at a specified time are deferred for repayment on a new schedule following negotiations between the creditor and debtor.

- Debt Service

The amount of funds used for repayment of principal and interest of a debt.

- Debt Sustainability

Sustainable debt is the level of debt which allows a debtor country to meet its current and future debt service obligations in full, without recourse to further debt relief or rescheduling, avoiding accumulation of arrears, while allowing an acceptable level of economic growth.

- Debt Sustainability Analysis

This is conducted in the context of medium-term scenarios. These scenarios are numerical evaluations that take account of expectations of the behaviour of economic variables and other factors to determine the conditions under which debt and other indicators would stabilize at reasonable levels, the major risks to the economy, and the need and scope for policy adjustment. In this analysis, macroeconomic uncertainties, such as the outlook for the current account, and policy uncertainties, such as for fiscal policy, tend to dominate the medium term outlook.

- Disbursement

The actual transfer of financial resources or of goods or services by the lender to the borrower.

- Domestic Borrowing

Government borrowing through issuance of local Government securities and direct borrowing from the Central Bank.

- Export Credit

Loans for the purpose of trade and which are not represented by a negotiable instrument. They may be extended by public or private entity. If extended by the private entity, they may be supported by an official government guarantee.

- External Borrowing

Government borrowing from both official (Government or Government agencies) and private institutions domiciled outside the country.

- Government Securities

Financial instruments used by the Government to raise funds from the primary market.

- Grant Element

It measures the concessionality of a loan, in the form of the present value of an interest rate below the market rate over the life of a loan.

- London Club

An international group of private commercial banks whose credits are not covered by government guarantees or insurance. The group is designed to provide a common approach to rescheduling of such debts owed by debtor countries.

- Monetary Policy

The management of money supply by the Central Bank in an economy to achieve desired economic conditions such as the overall level of prices.

- Present Value

The present value (PV) is defined as the sum of all future cash flows (interest and principal) discounted at the appropriate market rate. For a loan, whenever the interest rate on a loan is lower than the market rate, the resulting PV is lower than its face value.

- Official Development Assistance

Loans from official development agencies to countries received by the public sector, for promotion of economic development and welfare as the main objective and, extended at concessional financial terms (with minimum grant element of 25 per cent). Loans and credits for military purposes are excluded in this definition.

- Over the Counter

This is when financial instruments such as derivatives are traded outside a formal centralised exchange, such as, the Nairobi Securities Exchange.

- Paris Club

The Paris Club is an ad-hoc gathering of creditor Governments, chaired by high ranking official of the French Treasury, which meets for the purpose of rescheduling debts. The Paris Club is open to all creditor governments that are willing to adhere to its unwritten rules and practices and that have claims against a debtor country seeking rescheduling. Debtor countries must have strong adjustment programs supported by the upper credit tranche IMF arrangements before being considered for debt relief.

- Primary Market

This is a market where financial instruments are originated through initial issuance.

- Public Debt

This refers to outstanding financial obligations of the Government arising from past borrowing. It includes Government guaranteed debts to State Corporations and Local Authorities.

- Public Domestic Debt

Part of the overall debt owed by the Government to creditors domiciled in the economy. The debt includes money owed to commercial banks, non-bank financial institutions, individuals among others.

- Public External Debt

Part of the overall debt owed by the Government to creditors domiciled outside the economy. The debt includes money owed to private commercial banks, other governments, or international financial institutions such as the IMF and World Bank.

- Renminbi Bond

A bond issued outside of China but denominated in Chinese Renminbi (official currency of the People's Republic of China) rather than the local currency.

- Samurai Bond

A yen-denominated bond issued in Tokyo by a non-Japanese company and subject to Japanese regulations. These bonds provide the issuer with an access to Japanese capital, which can be used for local investments or for financing operations outside Japan.

- Secondary Market

This is a market where already issued financial instruments are traded.

- Sovereign Bond

A debt security issued by a national government within a given country and denominated in a foreign currency. The foreign currency used will most likely be a hard currency.

- Sukuk Bond

An Islamic financial certificate, similar to a bond in Western finance, that complies with Sharia, Islamic religious law. Because the traditional Western interest paying bond structure is not permissible, the issuer of a sukuk sells an investor group the certificate, who then rents it back to the issuer for a predetermined rental fee. The issuer also makes a contractual promise to buy back the bonds at a future date at par value.

- Suppliers' Credit

An arrangement under which a supplier or exporter agrees to allow the customer to defer payment under a sales contract.

- Tap sale

It is a continued issuance of a security after its original auction where there was an under subscription.

- Treasury Bills

It is a short-term borrowing instrument issued by the Government to finance the budget.

- Treasury Bond

This is a medium to long-term term debt instrument issued by the Government to finance the budget.

- Yield Curve

It is the relationship between the interest rate and maturity of bonds. A normal yield curve shows interest rates for short-term securities lower than interest rates for long-term securities.

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